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EFRAG
Attn: Mr. Hans Buysse
President of the EFRAG Board
CC: Interim-Chair of the EFRAG
Sustainability Reporting Board
35 Square de Meeûs
B-1000 Brussels

Our ref: RJ-EFRAG 619
Direct dial: Tel.: (+31) 20 301 039
Date: Amsterdam, 8 August 2022
Re: EFRAG Draft ESRS EDs

Dear Hans,

The Dutch Accounting Standards Board (DASB) welcomes the opportunity to respond to the draft European Sustainability Reporting Standards (ESRS) published for public consultation on April 27, 2022. The DASB believes mandatory sustainability reporting can contribute to accelerating the transition to a sustainable economy. The DASB understands the urgency and supports the development of mandatory sustainability reporting standards that ensure high quality, consistent and comparable reporting.

We value and appreciate the enormous amount of work done by EFRAG. The draft ESRS are substantive, ambitious and cover a wide range of Environmental, Social, and Governance (ESG) topics. Given the magnitude of the standards and the relatively short consultation period the DASB requested its Working Group Sustainability Reporting (hereafter WG) to take notice of all standards and prepare the formal consultation reaction to be included in the survey. The WG consists of sustainability experts and is diverse in composition representing reporting entities, auditors, investors, and a wide range of users and stakeholders of corporate reporting (e.g., academics, trade unions and NGOs).

On April 28, 2022, we sent a letter to express our fundamental concerns and some suggestions for improvement with respect to the earlier version of the ESRS. We noticed that EFRAG made valuable adjustments to the draft ESRS compared to the previous version published early 2022. However, our fundamental concerns with the previous version of the ESRS to a large extent still exist. This is of course, given the ambitious timelines, understandable. However, since our fundamental concerns still exist, and we fear the size and design of the survey might not highlight our most pressing points of attention we send you this letter accompanying our consultation reply shared with you via the designated electronic way. In this letter we highlight our fundamental concerns and share our suggestions for improvement with the draft ESRS. We would also like to refer to our letter of April 28, 2022, with reference RJ-EFRAG 618 A for further background on the concerns mentioned in this letter.

Fundamental concerns and suggestions for improvement
We have the following fundamental concerns on the architecture and design of the draft ESRS, including lack of international alignment. These concerns address the essence of sustainability reporting. We provide key suggestions for improvement of which we are of the opinion it will improve the quality of sustainability reporting. Moreover, adjustments and improvements of the architecture and design of the ESRS will be much more difficult later in the process than alterations to individual disclosure requirements, and therefore need to be addressed upfront. We hope our views and feedback will help you strengthen the draft ESRS to a coherent set that will standardize sustainability reporting, and thereby contribute to an accelerated transition to a sustainable economy and help redirect financial market funds to sustainable investments.

Our concerns and suggestions for improvement include:

1. ***Materiality principles***

The draft ESRS are based on a double materiality assessment which resulted in several sector-agnostic sustainability topics. We support the application of double materiality in the ESRS but we believe materiality should more clearly drive the disclosure requirements and its -principles be better articulated.

The sector-agnostic disclosure requirements are presumed to be material for every company, with a rebuttable option available indicating that a reporting company explicitly explains why a topic is not relevant. This is an extensive approach. We would like to stress that sustainability reporting has been driven by a thorough materiality analysis for many years. Deciding subsequently that all topics are material to all companies and applying the rebuttable presumption after the materiality assessment contradicts the existing approach. The current topics of the sector-agnostic standards cover a wide range of sustainability topics. Moreover, in our experience it is often more difficult to explain why a topic is not material then to explain why a topic is material. Therefore, we believe in continuation of current practice of materiality assessment for sustainability topics indicating an analysis of what is material. We believe materiality principles can be better articulated to ensure consistent application and comparability.

<u>Suggestion for improvement</u>
We suggest continuing the current approach in practice to materiality assessment of sustainability topics. Furthermore, we recommend clarifying the principles to be applied in the materiality assessment and we refer to GRI as an example of clear guidance on this matter. We would expect that the guidance clarifies that factors such as listing and size which are both relevant for the impact of the undertaking should be considered during the materiality assessment.

We therefore suggest:
a) removing the rebuttable presumption concept from the ESRS (ESRS 1-57) and express materiality assessment as the leading principle. The ESRS should provide more guidance on materiality principles and the assessment to identify the impacts that are material for users of the sustainability information;
b) if the rebuttable presumption should be retained, we suggest to limit the number of requirements that would, in principle, be always material and define in the sector specific standards which topics/items are considered to be material and then allow companies to use

the rebuttable presumption. The ESRS should make it clearer that it is possible and even likely that some topics are not material, as the current wording of ESRS 2 that all standards apply seems to suggest that most of the time these topics are material and hence obligatory for disclosure which is not always the case, for instance for the water and biodiversity standards. A thorough materiality assessment should lead to relevant and concise reporting focusing on the most relevant material topics.

2. *Complexity: risk of lower quality reporting*

2.1.Number of requirements for first-time reporters

The current draft ESRS are very comprehensive, complex and contain a high level of detail. This will already be challenging for even the largest (listed) reporting companies. Although non-listed companies have one year relief, we still have serious concerns that the disclosure requirements are overwhelming for non-listed large companies, most of which can be seen as "first time reporters" on sustainability information. This concern is based on the fact that a significant part of these non-listed companies do not have sufficient capabilities and recourses available within the companies to determine a strategy, plans and targets on all sustainability topics within the short period of time remaining till 2025. Combined with the lack of capacity of sustainability advisors and assurance providers to fill the gap, given the large number of first-time reporters, we foresee serious challenges. Based on the draft ESRS we fear that the size may hinder access to relevant and concise information for users of the Sustainability Reporting.

<u>Suggestion for improvement</u>

In order to help the large group of "first-time reporters", we suggest limiting the number of mandatory disclosure requirements for those companies to a CSRD minimum; for example by focusing on disclosures on plans and policies and several specific performance metrics considered most important and prescribe other disclosure requirements on a voluntary basis. After 2025 voluntary disclosure requirements can be made mandatory – gradually phased in or all at once – eventually obligating all undertakings to report on a more comprehensive set of disclosure requirements. This will give companies time to implement an ESG strategy, well-considered plans and policies needed and to implement an internal process for registration and reporting of sustainability information. This also prevents disclosures becoming required now, while in a few years it turns out that actually there are no strong demands from a users' perspective for such disclosures.

2.2.Number of targets

The draft ESRS introduce targets across all areas as mandatory disclosure. We fear that the current requirements on targets for all areas dilute the focus of undertakings on the most material topics and are therefore a risk for quality of the targets set and execution of required actions. As mentioned above we sincerely ask you to reconsider the materiality principles and to consider a more phased in approach to the disclosure requirements. If EFRAG is not willing to do this we kindly ask you to reconsider the number of targets required. Compliance with the undertakings' policy and transparent disclosures on the status of the policy should suffice in most cases. Furthermore, we believe the ESRS exceed the CSRD requirement on this point. We think it is appropriate to ask companies to disclose whether targets are set on material items and their performance on these, but we doubt whether ESRS should require companies to set targets such as required in ESRS E1-27 unless explicitly required by the CSRD.

Suggestion for improvement

We recommend limiting the requirement to have targets only for areas of strategic importance for an undertaking and those addressing the most severe risks on the environment and people for an undertaking (which in most cases will align with the identified material topics) which will facilitate the focus of users of sustainability information to the most relevant information. From a user's perspective this would provide more relevant and focused information. In our opinion the ESRS should not exceed the CSRD's requirements at this stage.

2.3.Inconsistent and infinite wording increases reporting complexity

In addition, we noted the use of infinite wording such as 'any' and 'all'. Examples of infinite wording can be found in ESRS S1, disclosure requirement S1-4 (heading/32), S2-4 (heading/26), and S2-5. Not all terms are defined, for example 'other work-related rights' (S1-21, 98) is not defined. Within the ESRS S1 besides the similarly defined terms 'own workforce' and 'own workers' ESRS S1 also uses the (undefined) term 'own employees' (S1-10, S1-24) and it is unclear if this is an inconsistency or a different term. Another unclarity is how to report on flex workers since they are defined as 'own workforce' as well as 'workers in the value chain'. Infinite wording, inconsistencies and unclarities in reporting hamper concise and clear standards. Consequently, difficulties will arise during the preparation of sustainability statements and discussions between preparers and auditor on the preferrable interpretation are foreseen, resulting in less comparable information. Also, infinite wording may conflict with the materiality approach.

Suggestion for improvement

We suggest removing the infinite wording and to make sure that used wording and definitions are clear and consistently applied.

3. *Limited alignment with European legislation and international standards on sustainability reporting*

The complexity of the ESRS (concern 2) is increased by current limitations in the alignment of ESRS with European legislation and international standards. First, the CSRD has been adjusted during the trilogue which resulted in alterations of article 19a and 29a in the CSRD, the base of the ESRS. Consequently, the ESRS should be adjusted accordingly. Furthermore, within the ESRS references are made to several EU legislation which are still in development (e.g. the proposal for a Corporate Sustainability Due Diligence Directive) creating possible future deviations between legislation.

Moreover, the ESRS also contain references to acts and plans which are not legislation. Those should not be part of the ESRS since they then unintentionally become legislation. See e.g. the disclosure requirement on incentive schemes regarding sustainability, which implicitly introduce the requirement to have such a scheme in place (ESRS 2, DR2-GOV4, paragraphs 62-64). This also applies to the references made in e.g. the Pollution and Biodiversity standards.

Lastly, alignment (compatibility) with international standard setting is not yet sufficiently visible in the draft ESRS. See for example the deviations between ESRS and IFRS S1 and S2 and the GRI Standards as highlighted in the comment letter on the ESRS issued by GRI on June 20, 2022. To enhance the level playing field for multinational companies and stimulate standardized information for investors, alignment and/or compatibility with international standards is essential through a building block approach.

Suggestion for improvement

- Review ESRS on alignment with the amended CSRD.
- Remove references to individual directives, acts and plans from the main text and create an appendix to refer to. Preferably in this appendix the hierarchy of legislation should be visible (regulation, directive, and other such as acts, plans etc.). This would also be much easier from a “maintenance” perspective.
- Seek further alignment with IFRS S1 and S2 and the GRI Standards and use the IFRS standards as the starting point for disclosures. ESRS should only address incremental disclosure requirements in case of serious shortfalls in IFRS S1 and S2 (for example due to the application of double materiality).

4. *Sustainability reporting within larger (non-EU) groups*

The scope of the CSRD has broadened as outcome of the trilogue discussions. Non-EU undertakings with a significant activity on the EU territory generating a net turnover of more that EUR 150 million will be in scope of the CSRD as well. These companies have to prepare (consolidated) sustainability reports in accordance with EU requirements with respect to their EU activities.

In addition, there are also many large EU-undertakings which are part of an international group of undertakings of which the group prepare consolidated sustainability information based on another reporting framework. This results in an obligation for these EU undertakings to prepare (consolidated) sustainability reporting under EU requirements as they are not meeting the requirements of an ‘exempted subsidiary undertaking’.

As requirements differ within different jurisdictions this would create a large (administrative) burden for companies to report under different reporting frameworks which could ultimately result in different metrics on similar material topics. In addition, it also results in all kinds of practical issues such as how to deal with group companies within the value chain of a reporting company/branch under EU requirements while the group is being controlled by group management reporting under a different sustainability reporting framework. The current ESRS do not provide guidance on how to deal as a reporting company within a global group and does not provide options to make use of consolidated information already available.

Suggestion for improvement

We therefore suggest facilitating undertakings in ESRS as much as possible only having to provide one set of sustainability information within an international group of undertakings, instead of having to prepare different types of sustainability reporting within one group and relieve the (administrative) burden for undertakings. It would prevent companies to have to prepare all different sets of information based on legal requirements instead of a stakeholder need. If not possible we ask EFRAG at least to consider allowing these subsidiaries to report metrics under different sustainability frameworks within an ESRS based sustainability report as companies will be able to use the information available for group reporting purposes. In the Netherlands, for instance, we provide options within the Dutch Accounting Standards to apply the accounting principles under several IFRS standards such as IFRS 16. This helps companies not having to account for leases in two different methods as there are differences between the Dutch Accounting Standards and IFRS on lease-accounting.

5. Sensitive information

Forward-looking information is an essential part of the management report and also required in the sustainability report (art. 19a sub 2 a(iii) CSRD). We generally support forward-looking information in the sustainability report. However, specific elements of forward-looking information might be of sensitive nature and could result in the company being threatened from a commercial or legal perspective. For example, in a large number of disclosure requirements companies are required to provide forward-looking information including investments plan for the longer term. If companies are required to disclose (competitively) sensitive information this might harm the (legal) position of the company or even in extreme situations have impact on the robustness of the business model or the validity of the going concern assumptions in the (near) future.

<u>Suggestion for improvement.</u>

In our opinion EFRAG should include an exemption for such sensitive information in the ESRS standards. Within art. 2:391 sub 2 of the Dutch Civil Code regarding the management report such exemption has been implemented: '*The management board report shall make mention of the course of events to be expected; in doing is, attention shall be paid especially, <u>insofar as important interests do not oppose to this</u>, to investment, financing and staffing and to circumstances of which the development of turnover and profitability depends.'* We strongly suggest for ESRS to include a similar exemption more explicitly in the ESRS to prevent companies from mandatory provision of information that could harm the company's business activities. Art. 29a of the CSRD Compromise text already contains such exemption for trade secrets as defined in the Trade Secrets Directive. This exemption in the CSRD should also be mentioned in the ESRS itself and we suggest including a more general exemption in ESRS with specific guidance on whenever the use of this exemption is acceptable or not. In the end we consider both the public as well as the assurance provider as a safeguard that a company will not abuse this exemption.

6. Risk of trickle-down effect

The current draft ESRS request significant information on the impacts in the value chain. Our concern is that reporting companies may decide to send out elaborate information requests to for example SME suppliers who are not yet equipped to report extensively on their sustainability performance. SMEs may face a significant trickle-down effect while the European Commission intends that non-listed SMEs will not be required to report, and listed SMEs should report in a proportionate and relevant to the scale and complexity of the activities, and to the capacities and characteristics of the SMEs (art. 29c CSRD).

<u>Suggestion for improvement</u>

We believe the scope of the CSRD (explicitly excluding non-listed SMEs) is at odds with the value chain reporting ambition (implicitly including non-listed SMEs). Consequently, this contradiction embedded in the CSRD hampers an easy suggestion for improvement. However, given the scope of the CSRD and the value chain reporting ambition, we believe that value chain information should be at a less detailed level within the boundaries of impact- and materiality assessment. Facilitating the use of approximations and extrapolations might be helpful in this case. This lowers the reporting burden that may inadvertently be placed on suppliers that fall outside the scope of the CSRD. Furthermore, insight in the impact is necessary. We would advise EFRAG to analyse the impact of the CSRD and ESRS on non-listed SMEs, and subsequently to review all disclosure requirements in the draft ESRS on the consequences for reporting companies and their suppliers in the value chain.

7. ***Ambitious timeframe: risk for high-quality standards***

The need for a swift implementation of the EU sustainable finance package is clear. However, due process is needed for high-quality legislation, especially in a regulatory field under development such as sustainability reporting. High-quality standards will result in workable and high-quality reporting, will support auditability by assurance providers and will facilitate the transparency needs of stakeholders. Naturally, the CSRD prescribes a mandatory, ambitious timeframe, firstly resulting in reporting for listed companies over the reporting year 2024. We believe, however, that the timeline of the public consultation and subsequent changes resulting to adopted standards is extremely challenging.

<u>Suggestion for improvement</u>

We suggest to (i) limit the required disclosures topics in the first batch to a minimum; (ii) focus for the first batch on the cross-cutting, E1, S1 and G standards; (iii) include some elements in the sector standards that are currently part of the sector-agnostic standards; and (iv) trim down to CSRD minimum in the first batch and include additional requirements subsequently.

By simplifying and trimming down the ESRS to the CSRD minimum we believe EFRAG will be able foster the quality of the ESRS within the very limited timelines and therewith of the sustainability reporting.

Our feedback is meant to help build the ESRS in such a way that the sustainability information in annual reports will be relevant, comparable and reliable for all stakeholders as of the implementation of CSRD and onwards.

Please feel free to contact us if you wish to discuss the contents of this letter.

On behalf of the DASB and Olga Smirnova and Simon Braaksma as co-chairs of the DASB WG Sustainability Reporting.

Yours sincerely,

G.M. van Santen
Chairman of the Dutch Accounting Standards Board