EFRAG
Attn. Mr. Jean-Paul Gauzès
President of the EFRAG Board
Square de Meeûs 35
B-1000 Brussels
Belgique

CC attn Mr. Sven Gentner
Head of unit,DG FISMA, Corporate Reporting,
Auditing Credit rating agencies
European Commission

RAAD VOOR DE JAARVERSLAGGEVING

Secretariaat:
Antonio Vivaldistraat 2, 1083 GR Amsterdam
Postbus 7984, 1008 AD Amsterdam

T +31(0)20 301 03 91
secretariaat@rjnet.nl
www.rjnet.nl

Our ref: RJ-EFRAG 618 A
Direct dial: Tel.: (+31) 20 301 039
Date: Amsterdam, 28 april 2022
Re: Fundamental concerns and suggestions for improvement with respect to the draft European Sustainability Reporting Standards (ESRS)

Dear Jean-Paul,

The Dutch Accounting Standards Board (DASB) welcomes the proposal for the EU Corporate Sustainability Reporting Directive (adopted in 2021) and the related drafting of the European Sustainability Reporting Standards (ESRS) by EFRAG. The DASB believes mandatory sustainability reporting can contribute to accelerating the transition to a sustainable economy. The DASB understands the urgency and supports the need to develop mandatory sustainability reporting standards that ensure high quality, consistent and comparable reporting.

The DASB has formed a working group (hereafter WG) on sustainability reporting. This 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). The WG members read and analyzed the 24 draft ESRS as made public by EFRAG. We value and appreciate the enormous amount of work done by EFRAG. The draft ESRS are substantive, ambitious and cover a wide range of ESG topics.

Fundamental concerns
However, we have several fundamental concerns with respect to the draft ESRS which we would like to express to you prior to the public consultation. We are fully aware that the draft ESRS are dependent on the CSRD proposal. Consequently, that might limit EFRAG in fully addressing our fundamental concerns. Nonetheless, we hope our views and feedback will help you strengthen the draft ESRS to a coherent set that will standardize sustainability reporting, contribute to accelerated transition to a sustainable economy and help redirect financial market funds to sustainable investments.

Our concerns include:

1. *Absence of holistic review of draft ESRS*
   In the current draft ESRS architecture, key building blocks such as strategy, governance and risk management are part of several draft ESRS and overlap with corporate reporting standards. Consequently, key information will be scattered throughout the Sustainability Statements and management report. We believe it is desirable to allow integration of this information since it facilitates information accessibility while simultaneously increases the workability of the draft ESRS.
2. *Limited alignment with international standards*
   Alignment (compatibility) with international standard setting, for instance with standards (to be) issued by the ISSB or SEC, is not yet sufficiently visible in the draft ESRS. To en-

hance the level playing field for multinational companies and stimulate standardized information for investors, alignment and/or compatibility with international standards is essential.

3. *Materiality shortcomings*
   The sector-agnostic topics are presumed to be material for every company, with a rebuttal option available which is considered rare. However, the current fifteen topics of the sector-agnostic standards cover a wide range of sustainability topics. The lack of detailed guidance on the rebuttal option will make the materiality analysis complicated for reporting entities and difficult to assess and validate for auditors. In our experience it is often more difficult to explain why a topic is not material then to explain why a topic is material.
4. *High risk on trickle-down effect*
   The current draft ESRS request significant information on the impacts in the value chain. Our concern is that reporting companies may need to send out elaborate information requests to for example SME suppliers who are not yet equipped to report extensively on their sustainability performance. Unintentionally, the full administrative ESRS reporting burden would then shift from large companies to SMEs. While the European Commission intends that non-listed SMEs will not be required to report, and listed SMEs should report on a limited and specific set of ESRS for SMEs, SMEs may face a significant trickle-down effect.
5. *Workability threatened by complexity*
   The current draft ESRS are very comprehensive and contain a high level of complexity and detail. This will be challenging for even the largest (listed) reporting companies, but it may also confuse rather than inform stakeholders. Furthermore, we are concerned that the requirements are overwhelming for non-listed large companies, especially for first time reporters, and may hinder access to relevant and concise information for users of the Sustainability Statements.

Main suggestions for improvement
We have three main suggestions for improvement that, in our opinion, will increase the workability of the standards while simultaneously do not detract from the objectives of the standards.

Our suggestions can be summarized as follows:

- *Core and more*
  Currently, draft ESRS contain disclosure requirements that, in many cases, demand a high level of detail, which can complicate both the reporting process and the assessment of the undertaking's position and performance by users. Reviewing the proposed disclosure set on relevance is key. We propose a core option and comprehensive option for all standards as applied by the GRI Standards. Consequently, reporting will be easier for first time reporters, companies that just meet threshold criteria and companies that are capital intensive but low on employees (e.g., housing corporations). Moreover, a 'less is more approach' decreases the risk of reporting irrelevant information for less material topics.
- *Connectivity in presentation is essential*
  Integration of key information on building blocks such as strategy, governance and risk management and of financial materiality disclosures within the management report will help create a full picture of a company's performance over the year, both on financial and sustainability topics. This connectivity is key to provide users with the right contextual information.
- *Facilitate data to increase quality of Sustainability Statements*
  Currently, there are many reference points which are widely accepted and used in sustainability reporting. However, the variety of these reference points complicate the comparability of sustainability reporting and increase the complexity of preparing and assuring sustainability reporting. Therefore, we suggest that the EU facilitates sustainability reporting by building authoritative reporting databases on topics such as living wages, endangered species lists, ecosystems under pressure and scope 3 emission factors for certain countries as a basis for standardized assumptions and include those as required/optional in the application guidance.

Please find a more in-depth elaboration of our concerns and suggestions in the appendix.

Ambitious timeframe: risk for due process and 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. We ask you to consider in what way our concerns can already be mitigated in the drafts you will make public since we strongly believe it is in our common interest to draft high quality reporting standards. Notably, we believe it is essential that the basis for conclusions accompany the drafts in the consultation period and we urge EFRAG to issue the bases for conclusions as soon as possible but no later than May. 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.

We fully understand the need in the accelerated process to use the political momentum. However, we believe the timeline of the public consultation and subsequent changes to the standards to bring them to the final stage is extremely challenging. Therefore, we strongly recommend the European Commission to extend the deadline for the finalization of ESRS to provide EFRAG the necessary additional time to finalize the new standards and for example incorporate the suggestions made in this letter. Companies reporting in 2025 over the reporting year 2024 will still need sufficient time to prepare for the upcoming reporting requirement. However, we believe that improvement or simplification of the draft ESRS, may be of significant benefit in reducing the implementation time and effort and therefore an appropriate tradeoff between these elements should be made. If the feedback results in fundamental changes to the ESRS compared to the consultation version, we advise to add a shorter, second consultation period to strengthen commitment and avoid fatal flaws in the final standards.

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 DASB WG Sustainability Reporting,

Yours sincerely,

Gerard van Santen
Chairman DASB

APPENDIX

Holistic review of draft ESRS and strengthening of international alignment/compatibility is indispensable
Sustainability reporting frameworks have progressed from the initial standalone standards such as the GHG protocol (on one topic) to a more integrated approach culminating in standards such as the Integrated Reporting <IR> Framework. It must be the ultimate goal of sustainability reporting to be fully integrated with financial reporting to build complete corporate reporting that combines relevant and reliable financial and non-financial information. In the current draft ESRS architecture, this idea of integration is optional and not aligned with the financial reporting frameworks of the EU Accounting Directive and EU-IFRS that is predominantly used. In addition, alignment and/or compatibility with international standard setters, such as the ISSB or the SEC, is not yet sufficiently visible in the draft ESRS.

Currently, the draft ESRS building blocks of business model, strategy, targets, governance, and risk management are partly included in the management report and partly included in the Financial Statements. The current infrastructure of draft ESRS which promotes separate Sustainability Statements, and repeating parts of the building block information under each topical standard, lead to the following issues:

1. In the current draft ESRS, considering that preference is given to separate Sustainability Statements, a lot of information will need to be repeated across multiple sections of the report. This will make reporting less concise and information less connected to significant other information.
2. The business model, strategy and risk management are not only relevant for sustainability-related issues. To understand the choices made by and the direction taken by management, it is important to understand the sustainability strategy, risk management, targets and governance within the context of the full strategy agenda. Reporting on the sustainability strategy separately will not inform stakeholders of the priorities from management, the choices made and the subsequent allocation of resources, and may not be consistent with the outcomes of the materiality assessment which also includes financial targets. It is advisable to report on business model, strategy, risk management, targets and governance in the broader view of the full business context.
3. The current ESRS draft set is independently developed within the EFRAG Working Groups. While the draft ESRS are partly based on existing reporting frameworks for sustainability, such as GRI, The GHG Protocol and TCFD, other major reporting frameworks are currently also drafting standards, such as the ISSB. We urge to align with any (draft) standards, at least the ISSB, in order to standardize sustainability reporting worldwide.

<u>Suggestion for improvement</u>
We advise to report on the ESRS building blocks of business model, strategy, targets, governance and risk management in a holistic manner, integrating this information within the relevant sections in the management report, in line with adopted integrated reporting best practices. We also advise to align the current ESRS with the draft IFRS Sustainability Disclosure Standards published by the ISSB to promote international alignment of standards.

Materiality shortcomings
The draft ESRS are based on a double materiality assessment which resulted in several sector-agnostic sustainability topics. Those sector-agnostic topics are presumed to be material for every company, with a rebuttal option available that should be rarely used. This means that the draft ESRS assume the full range of sustainability topics are material for each company within the scope of the CSRD. In our view, this assumption is not in line with relevant and concise reporting.

Furthermore, the lack of detailed guidance on the rebuttal option will make the materiality analysis complicated for reporting companies and difficult to assess for auditors. While the draft ESRS offer a comply or explain principle, the lack of guidance on rebutting the materiality assumption leads to insufficient comfort for reporting companies and their auditors to conclude on the rebuttal option.

Suggestions for improvement
It seems appropriate that the ESRS should leave more room for materiality considerations per sustainability topic and provide more detailed guidance on the specific requirements to rebut the materiality assumptions. We recommend including a comprehensive set of disclosures for highly material topics and limiting disclosure requirements to a core option for topics that are considered less material. To avoid cherry-picking, materiality should be defined by the standard setter. Overall, faithful representation of material topics should follow the 'substance over form' principle and not merely their legal form. This will enhance the reliability of the Sustainability Statements.

High risk of trickle-down effect
Draft ESRS contain a significant number of value chain information requirements. Consequently, reporting companies may feel required to request sustainability information from their value chain partners, primarily their suppliers. We are concerned that this may lead to reporting companies sending out elaborate information requests to SME suppliers, who are not yet equipped to report extensively on their sustainability performance. Unintentionally, the full administrative ESRS reporting burden would then shift from large companies to SMEs. While the European Commission has intended that non-listed SMEs are not required to report and listed SMEs should only report based on a limited and specific set of ESRS for SMEs, SMEs may face a significant trickle-down effect.

Suggestion for improvement
First and foremost, a thorough discussion and analysis of the impact of the CSRD proposal and draft ESRS on SMEs is needed. To substantiate the discussion, we would advise EFRAG to review all disclosure requirements in the draft ESRS on the consequences for reporting companies and their suppliers in the value chain We believe the scope of the current CSRD proposal is at odds with the value chain reporting ambition. Consequently, this contradiction embedded in the CSRD proposal hampers an easy suggestion for improvement. However, given the current scope of the CSRD proposal and the value chain reporting ambition, we believe that value chain information should be at a less detailed level. This lowers the reporting burden that may inadvertently be placed on suppliers that fall outside the proposed scope of the CSRD.

Workability threatened by complexity
The comprehensive and detailed draft ESRS are very complex. This may be overwhelming for non-listed large companies, especially for first time reporters. Reporting will require significant efforts due to the comprehensiveness and necessary detail, resulting in voluminous Sustainability Statements which may hinder access to relevant and concise information for users of the Sustainability Statements. A good example is draft ESRS E1, with some 80 disclosure requirements – but this comment applies to most draft ESRS.

Suggestion for improvement
We recommend considering a simplified approach for especially non-listed companies, focused on the needs of the users of the reporting. The approach to be followed could be 'core and more' approach, whereby certain ESRS main standards can provide guidance for specific topics or use an approach where non-listed companies only need to report on the most important disclosure requirements in the current draft ESRS. This will improve the efficiency of the allocation and pricing of capital and facilitate consistency in audit quality.

Core and more
The current set of standards are extensive and will be time- and resource-intensive for first-time reporters to implement. While the most recent CSRD proposal does give first-time reporters a transition period of three years to include information on the undertaking's value chain, we do believe that the full set of draft ESRS may prove an overload of information to report on especially

for first-time reporters, companies that just meet threshold criteria, and companies that are capital intensive but low on employees (e.g., housing corporations).
The draft ESRS contain a lot of disclosure requirements, and additional application guidance which adds provisions requiring further breakdowns of disclosure information, for instance, at country level, by topic, etc. Notably, every required breakdown leads to additional assurance work that needs to be performed. These breakdowns are only value-adding if the information leads to significant benefits for the users and are proportionate for reporting entities and auditors.

Suggestion for improvement
We would advise to propose a set of core standards and comprehensive standards, in line with the current GRI Standards. First-time reporters can then start with the core standards set, and gradually grow to more in-depth disclosures with comprehensive standards after a transition period.
Furthermore, one of the key elements of integrated reporting is to report relevant and concise information. It would be advisable to review if those detailed breakdowns actually contribute to stakeholder information needs or will only serve to fragmentize information and thus make it less relevant.

Connectivity in presentation and between sustainability and financial information is essential

Presentation
The current preferred choice of the draft ESRS is to separate relevant sustainability information in a single and separate Sustainability Statements section. Only EU-related sustainability information may be included in the Sustainability Statements. When companies also report on other sustainability standards, such as the IFRS Sustainability Disclosure Standards issued by ISSB or the OECD guidelines etc., this information will become disconnected from the main sustainability information. This means that the draft ESRS move away from the integration of corporate reporting.

Sustainability and financial information
To increase the relevance of corporate reporting, integrating financial and sustainability information is vital. The draft ESRS contain many requirements based on financial materiality that must be reported on in the Sustainability Statements because those requirements have not yet been sufficiently integrated into financial reporting standards and thus in the Financial Statements. The ultimate goal would be, in our view, that any information reported on under draft ESRS from a financial materiality perspective should be aligned with similar information required by financial reporting standards.

For now, this information is not yet part of financial reporting standards. If this information is then “hidden” in the Sustainability Statements of the report, two significant disadvantages occur. First, there is no connectivity between sustainability and financial reporting and second, investors and other stakeholders might make decisions based on the Sustainability Statements, missing important information about the financial stability and resilience of the reporting company.

Suggestion for improvement
It would be advisable to connect sustainability information, even when this is reported based on other sustainability standards within the Sustainability Statements.
It would be advisable to include information from a financial materiality point of view in the relevant sections in the management report/financial statements and not in the Sustainability Statements.

Facilitate data to increase quality of Sustainability Statements
To enhance the comparability and workability of the draft ESRS, we suggest that EFRAG provides or stimulates the provision of standardized data. Many companies will be reporting on sustainability information for the first time in the period 2023-2026 as specified in the CSRD

proposal. To provide comparable information and to lower the administrative burden, it would be advisable to provide certain general sustainability information elements on a standardized level. For instance, for GHG emissions, emission factors often differ between countries, but are also harder to obtain when reporting on scope 3 emissions. If the European Union can provide standardized emission factors for important GHG emissions sources, as well as information on products and deforestation, products with a high-human-rights risk in the value chain and/or in specific countries etc., it would lower the administrative burden for companies significantly and, at the same time, make reported information more comparable. This will also provide a reliable source of information that will support the sustainability assurance process.

Suggestion for improvement
We advise to review the draft EFRS to provide insight in the use of standardized assumptions or reporting elements. It would be advisable to use existing authoritative reporting databases such as the GHG Protocol website on emission factors as a basis for standardized assumptions and include those as required/optional in the application guidance. It is also possible to establish a European body that provide this kind of standardized information.

Regulating ambitions through sustainability reporting
In multiple places we have identified significant disclosure requirements to report on the progress in meeting ambitions set by the EU, which are not currently translated into law for reporting companies. For example: draft ESRS E5 Disclosure requirement 5.30 requests a description of how a company's targets contribute to the objectives of the EU Circular Economy Action Plan. This means that the sustainability reporting set is misused to set stronger requirements for companies than obliged by law. Disclosure requirements based on a voluntary or non-legislative set of measures should not be part of the draft ESRS unless they are clearly identified as voluntary disclosures and optional for companies. If the European Commission wants companies to include information on the contribution of their actions to certain EU goals, the goal or objective should be clearly defined in the draft ESRS or should be made clear by a specific reference to the EU target.

Suggestions for improvement
Remove non-binding ambitions as a benchmark for reporting on targets set within the draft ESRS.