Appendix

Ten suggestions for the revision of ESRS Set 1: Initial ideas by the DRSC Technical Committee on Sustainability Reporting

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Preamble

The Omnibus proposals of 26 February 2025 constitute a major shift in the EU corporate reporting landscape. The German accounting standards setter, DRSC, has closely followed this development and submitted a position paper including suggestions for changes to be envisaged for the CSRD legislative framework at the end of January 2025. One of these suggestions concerned a clear demand to EFRAG to revise the sector-agnostic ESRS Set 1 with a view to reduce bureaucratic burden for undertakings.

During past weeks, DRSC has entered into an intensive dialogue with so-called wave 1 undertakings to gain immediate insights into ESRS Set 1 reporting practices and related bureaucracy issues. Based on these outreach activities, and following in-depth discussions in our Sustainability Reporting Technical Committee, we concluded on the suggestions as explained below. These suggestions have been discussed with a clear commitment to political goals of the EU regarding the necessary transition of the European economy. The starting point of these ten suggestions is ESRS 2 as a general standard for the reporting on the topical ESRS.

Suggestion No. 1: Governance disclosures are important but could be significantly reduced in detail; greater focus on "managed" processes, particularly on risk management

Not only reporting undertakings benefit from the integration of sustainability aspects into their management systems but also the users of this information. In doing this, undertakings need to attach sustainability-related governance aspects the same level of attention as those intended for financial stakeholders.

On the one hand, disclosures on governance serve financial stakeholders as important information on the ability of an undertaking company to generate economic value in the future. On the other hand, such information helps other stakeholders to assess whether a sustainability-based entrepreneurial approach continues to be a guiding principle for the undertaking. However, based on insights from the first reporting season, practice has revealed that some disclosure requirements are less relevant for this purpose.

DRSC suggests reducing the granularity of such disclosures, in particular GOV-2; e.g. the requirement to disclose how frequently the administrative, management and supervisory bodies are informed about material impacts, risks and/or opportunities as the informational value is low. The same applies, among other things, to information on who informs these bodies on sustainability matters. At the same time, we argue that GOV-5 on undertakings' risk management and internal controls over sustainability reporting appears very relevant to stakeholders as it provides important information related to the actual and active behaviour of an undertaking's management.

Advantage of suggestion No. 1

Suggestion No. 1 helps reporting undertakings to focus on essential information both relevant for the undertaking itself and for stakeholders. This helps to significantly reduce bureaucratic

burdens by not having to provide less valuable information. The more general descriptions are still subject to external assurance.

Suggestion No. 2: Eliminate redundant reporting requirements throughout ESRS

ESRS prescribe similar or literally the same disclosures multiple times resulting in repetitive content of the sustainability report. On the one hand, the general disclosure requirements of ESRS 2 are further specified by topical ESRS. Examples include the GOV-Disclosure Requirements which are specified in ESRS E1 (GOV-3) and ESRS G1 (GOV-1); much more repetition is seen in the context of SBM- and IRO-1 disclosures. This causes redundancies in the sustainability report that need to be avoided as such repetitions may hamper the comprehensibility of sustainability reporting.

Furthermore, we note particular elements of disclosure being addressed multiple times also across the topical standards of ESRS Set 1 (i.e. excluding ESRS 1 and ESRS 2), e.g. disclosures on the protection of whistleblowers (including whistleblower reporting channels and grievance mechanisms) in all S-ESRS. Following, reporting undertakings need to take these up on the basis of a specific topical ESRS even if practice is organised on a different basis; be it centrally or based on sites/locations. As an example for the latter case, many construction undertakings have organised their grievance or whistleblower mechanisms per construction site, regardless of whether these relate to own employees or employees of a subcontractor. However, ESRS require undertakings to report on this aspect twice (according to ESRS S1 and S2).

Advantage of suggestion No. 2

Suggestion No. 2 contributes to the targeted elimination of reporting requirements causing redundancies in the sustainability report. For example, a better synchronisation with the set-up of undertakings' reporting systems helps better depict corporate practice, i.e., organisation and management. Consequently, by more focusing on corporate practice, the overall sustainability reporting could be more concise and provide more meaningful insights, resulting in a fair presentation of sustainability information.

Suggestion No. 3: Remove reporting requirements with unreasonable cost-benefit profile, in particular with regard to anticipated financial effects

Frage an den FA

Möchte der FA noch weitere Beispiele zu diesem Thema nennen?

ESRS contain certain disclosure requirements that result in high effort for undertakings to comply with but low information value for users. One particular example is the disclosure requirement both in ESRS 2 and in the E-ESRS to provide information on anticipated financial effects, i.e., financial effects which are not already reflected in the financial statements according to Annex II to the ESRS. The transitional provisions set out in Appendix C of ESRS 1 foresee that an undertaking may omit these disclosures for the first year of application and may further comply with the requirement by reporting qualitative disclosures for the first three years of application.

In financial reporting, future financial effects are regularly taken into account when preparing financial statements. Examples include the measurement of fair value of assets and liabilities and recognition of liabilities on the basis of future payment obligations. That said, the consideration of future financial effects in financial statements is subject to certain conditions, namely recognition and measurement criteria. These aim to ensure that financial statements provide

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fair and reliable information. Therefore, certain future financial effects are excluded from being recognised in financial statements because they do not represent fair and reliable pieces of information as they come with too high uncertainties. Finally, reporting practice has revealed that anticipated financial effects (in the aforementioned understanding) can only be calculated with very high effort but lack reliability and are, therefore, of little information value. By consequence, the associated cost and their benefit are not well balanced.

Generally, future financial effects from opportunities and risks, if not reflected in the financial statements, are discussed in the management report. Here, the provision of quantified data follows a strict management approach. Quantified data is only required if the management itself quantifies such effects for steering purposes. However, this does not only require relevant knowledge and experience but also the relevance of a quantification.

Accordingly, we think a quantification should only be voluntary. Narrative disclosures seem nevertheless helpful and, thus, should remain to be required.

Advantage of suggestion No. 3

Suggestion No. 3 would result into voluntary quantifications of anticipated financial effects for the purpose of sustainability reporting. This saves companies of considerable time and effort once the transitory period of three years expires. Furthermore, it would reduce the number of disclosures with little information value.

Undertakings of wave 1 and wave 2 would benefit from this relief as they would not need to quantify these effects after the end of the transitional period.

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Suggestion No. 4: Refine the requirements on the interaction of policies, actions and targets and their relation to IROs to better reflect undertakings' practices

Interaction of policies, actions and targets (PATs)

The situation where policies, actions, and targets are linked to each other in a strict "1:1:1" relationship rarely occurs in practice. In contrast, practice shows a variety of relationships, for example, a policy may relate to several targets, or a combination of actions aim at a specific target and vice versa. It is (1) very difficult to present, policies, actions and targets as if they were exclusively related to each other in a "1:1:1" relationship, and, (2) doubtful that this presentation constitutes meaningful information for users. Therefore, we believe that ESRS should clarify that this exclusive relationship is not required.

Interaction of PATs and IROs

Frage an den FA

Spiegelt der nachfolgende Abschnitt die Diskussion der letzten Sitzung angemessen wieder?

Sub-sub-topics as included in ESRS 1.AR16 are often attributed to several categories of IROs (or several "IROs"). In other words, there are situations where one sub-sub-topic can have more than one IRO. Furthermore, as with policies, actions and targets (PATs) outlined above, ESRS are understood to assume a one-to-one relationship between PATs on the one and IROs on the other hand, because ESRS 2 requires disclosure on policies to address IROs, and the glossary puts policies in the context of sustainability matters.

This often results in PATs not being considered as PATs in the spirit of ESRS if they do not refer to a particular IRO. Again, such a "1:1" relationship rarely exists in practice. To give an example: PATs can be designed to address one IRO, multiple IROs, a sub-sub-topic but no dedicated IRO, or even just a topic, etc. Regardless of this, ESRS force undertakings to create artificially a "1:1" relationship of PATs and IROs, which is clearly not meaningful for the aforementioned reasons. Therefore, we believe ESRS should clarify that such "1:1" relationship is not necessary.

Advantage of suggestion No. 4

Suggestion No. 4 would allow undertakings to better present, in a meaningful way, both the interaction (1) between policies, actions and targets, and (2) policies, actions and targets in connection with material impacts, risks and opportunities, according to their specific facts and circumstances. As a result, the sustainability report would include fair information as corporate practice would be reflected more accurately, given that undertakings could adapt disclosure requirements to how sustainability is addressed in the corporate landscape. Furthermore, avoiding an artificial presentation of disclosures means lower cost of reporting as undertakings would not be forced to develop a narrowly prescribed form of presentation.

The higher level of discretion as described above could, in particular, help wave 2 undertakings in conducting their DMA and in the presentation of sustainability information. It will also help wave 1 undertakings in preparing their future reports.

Suggestion No. 5: DMA – Addressing gross risks in a more meaningful way

ESRS and accompanying Implementation Guidance on the Double Materiality Analysis (DMA) leave it unclear whether instruments or actions in place to avoid negative impacts can be taken into account in the assessment of potential impacts' materiality. ESRS materials are understood to prescribe a worst-case consideration as matter of principle. As a result, negative impacts and risks are overstated in the sustainability report to a great extent, e.g., anticipated negative financial effects are exaggerated, undertakings must apply an assumption whereby negative impacts in the supply chain cannot be mitigated at any case.

Avoidance measures – say a wall circling a production site as the most intuitive example – aim at lowering the probability of a given negative impact towards zero. Therefore, we believe that an undertaking's measures designed to avoid negative impacts should be considered in the DMA. This implies that undertakings will be allowed to assess the materiality of such impacts based on a net-approach if (1) measures, systems or processes to avoid negative impacts have been established and (2) there is no evidence that these measures, systems or processes are not effective. However, this needs to be explicitly clarified in ESRS. We note that EFRAG is already working on an amendment to IG 1 "Materiality assessment"; however, we believe that a clarification in ESRS is necessary.

Advantage of suggestion No. 5

Suggestion No. 5 aims at focusing an undertaking's DMA efforts to a reasonable degree to net risks. Such an DMA approach would particularly help undertakings of wave 2, but clarification could also benefit wave 1 undertakings if it was considered in the ongoing EFRAG discussion regarding Implementation Guidance on "Gross vs. net" or as part of a revised Set 1. Note that, from a standard setting perspective, we clearly prefer the latter option.

Suggestion No. 6: DMA – Aligning the stakeholder definition with the revised CSDDD

The Omnibus revisions foresee for the CSDDD to incorporate an altered definition of the term "stakeholder". According to the proposal the definition will be limited to employees and their representation as well as human beings and communities whose rights or interests are directly affected by products and services and activities of an undertaking.

Furthermore, the Omnibus proposes to amend the necessary level for stakeholder involvement. It introduces the term of "relevant stakeholders" comprising "those stakeholders that have a link to the specific stage of the due diligence process being carried out (e.g., affected individuals when designing a remediation measure)", e.g. persons concerned by the planning

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of a remediation measure. In short, the focus of due diligence should lie on direct business partners (tier 1).

The aforementioned approach to stakeholder definition and engagement should similarly be reflected in the ESRS, e.g. in the categorisation of stakeholders (ESRS 2.SBM-1.45(a) ii.) which are partly determined by CSDDD. This may also affect the depth of the value chain under consideration (ESRS2.SBM-1.45.IRO-1.53(b)ii "business relationships"). Further impacts of the envisaged CSDDD changes could also be seen in the value chain across the entire Set 1 of the ESRS.

Frage an den FA

Ist der FA mit der Zielrichtung dieser Diskussion (Suggestion 6) einverstanden?

Advantage of suggestion No. 6

Suggestion No. 6 also aims at streamlining an undertaking's DMA efforts. Specifically, it aims at the range of relevant stakeholders, where such alignment could limit the scope to "direct" stakeholders. Given the specific facts and circumstances, undertakings may consider whether an expansion to further "relevant" stakeholders is appropriate. This will make the DMA more manageable and better reflect an undertakings' underlying economics. Again, such an DMA approach could help both wave 2 undertakings and wave 1 undertakings as part of a revised ESRS Set 1.

Suggestion No. 7: Harmonise the scope of consolidation of group undertakings to financial reporting; remove the concept of operational control

As a matter of principle, the scope of consolidation covers the parent undertaking of a group and all subsidiary undertakings. However, for reasons of materiality, a parent undertaking may conclude that not all subsidiaries are included in the consolidation. This means that one or more subsidiary undertakings are excluded from consolidation, i.e., are not consolidated, because these are not material for the group financial statements to provide a fair presentation of the financial performance and position of that group. If a subsidiary undertaking is not consolidated in the group financial statements (i.e., the consolidated financial statements), its assets, liabilities, income, expenses, etc. are not recognised in the group financial statements (as opposed to consolidated subsidiaries). The group balance sheet just contains the value of the investment associated with that subsidiary undertaking instead.

In our view it is essential that the scope of consolidation for sustainability reporting does not depart from the scope of consolidation for financial reporting. It is to be noted that the issue of reporting boundaries is subject to a separate discussion. For the transformational effect of all the sustainable finance regulation, including the sustainability reporting, putting sustainability issues and financial issues on the same level of importance is the key aspect. In other words: An undertaking's management shall consider both aspects equally and in connection when taking decisions. Connecting sustainability aspects and financial aspects in reporting is also referred to as connectivity.

However, connectivity of financial and sustainability reporting is hampered when KPIs are combined where the numerator and denominator do not share the same basis. Although we note that connectivity is currently not well developed in ESRS, in some circumstances the standards require references or reconciliations to line items in the financial statement, e.g., ESRS E1.34 on energy intensity, ESRS E4.AR18 on Capex/OpEx related to biodiversity. In particular, combined metrics such as energy intensity are of low information value or might even be misleading when their elements (energy consumption, net revenue) are measured on the basis of different

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scopes of consolidation. In this case, additional explanations and reconciliations are necessary.

As with the harmonisation of consolidation scopes there is clear case for avoiding particular accounting concepts which entail additional considerations by the reporting undertaking. In our view, the inclusion of the concept of operational control into ESRS can be traced back to a misunderstanding: Sustainability experts reported to a respective CDP survey that they worked with the operative control concept in their undertaking but were not aware of what that actually meant due to missing familiarity with financial accounting.

We strongly believe that a consistent regime of reporting requirements should be based on a consistent definition of what the reporting undertaking is including how it is circumscribed. In addition, we observed that the parallel concept to circumscribe the reporting undertaking based on operational control has resulted in a high effort for undertakings to (1) understand the exact meaning of the concept, (2) identify deviations from the scope of the consolidation as set so far and (3) reassess disclosures to be made under the assumption of operational control. We therefore urgently request that this concept no longer be applied to sustainability reporting.

With regard to the processual approach to the aspect of the scope of consolidation, we urgently recommend a corresponding clarification at Level 1 legislation, i.e. in the Accounting Directive. If this is not done, a clarification in the ESRS is essential.

Advantage of suggestion No. 7

Suggestion No. 7 would help undertakings to have harmonised scopes of undertakings to include in the consolidation at group level. Furthermore, it would put an end to have undertakings dealing with the concept of operational control. This would facilitate the work on corporate reporting at group level and eliminate particular situations where additional work is to be performed to include unnecessary explanations and reconciliations in group reporting and to apply different concepts of what the term reporting entity means. This measure could immediately benefit undertakings in wave 1 and, once reporting obligations are in place, undertakings in wave 2.

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Suggestion No. 8: Value chain – Easing the use of estimates

ESRS 1.69 addresses the case that an undertaking cannot collect primary date about its upstream and downstream value chain after putting in reasonable efforts to do so. In these circumstances, the undertaking is allowed to estimate the information needed to comply with the requirement to include value chain considerations in its own reporting.

This requirement represents a major challenge for undertakings. Although primary data is generally preferable to estimates, the situation described in ESRS 1.69 as an exceptional case is far more common: Information about impacts of an undertaking's business associated with its value chain require data relating to products and services obtained by that undertaking from its suppliers. As an example, for determining Scope 3 greenhouse gas emissions associated with an undertaking's business it needs information on the greenhouse gas footprint related to the product obtained, rather than the supplier's total footprint. However, those data are not available on a primary data basis. Instead, undertakings can make use of industry benchmarks or databases, which are also not regarded as primary data sources but contain estimated data. However, the ESRS only allow the estimation of data if the 'reasonable effort' condition is met. This condition involves a high degree of effort, which in almost all cases does not even result in primary data being obtained after reasonable effort has been made.

We strongly recommend that the ESRS allow estimates with regard to the value chain without such a condition. At the very least, the option for value chain estimates should be much more easily available. We also recommend giving significantly more leeway to the undertaking's

assessment of which parts of the value chain are relevant for sustainability reporting. Currently, the ESRS suggest a fundamental consideration of the entire value chain.

Advantage of suggestion No. 8

Suggestion No. 8 would harmonise the requirements in ESRS with the data collection and reporting tools actually available. It would further reduce the costs of reporting as undertakings would not need to carry reasonable effort before they are allowed to use estimations for information necessary to comply with the reporting requirements associated with the value chain.

Suggestion No. 9: Give prevalence to a principles-based approach emphasising fair presentation

Appendix 1 of the ESRS 1 contains qualitative characteristics of information and respective descriptions. However, these qualitative characteristics do not play a particular role in ESRS. As a result, reporting and the presentation of disclosures can only be made within very strict limits which constitute high effort for undertakings and little benefit for users. Examples of this include the aforementioned relationships between IROs and PATs, or the frequent repetition of information in the sustainability report.

We believe that undertakings need significantly more discretion in reporting and in the presentation of disclosures in order to provide useful sustainability information. In other words: To achieve this, the qualitative characteristics must be given the role of overarching principles, as is the case of other reporting frameworks. In addition, it should be considered to make better use of the concept of “fair presentation” which is seen as a widely accepted principle of corporate reporting. We note that ESRS 1 mentions the characteristic “faithful representation”, but we think this should be clearly aligned with the principle of “fair presentation”. Furthermore, the “fair presentation”-principle could be complemented with the concept “substance-over-form” which would open leeway to present disclosures according to the undertaking’s organisation of management and business.

As a result, both undertakings and their external assurance service providers could achieve a more holistic approach to reporting. In addition, it could also help external assurance service providers to open new ways of judgment and not only to look at particular processes, e.g. DMA, or individual disclosures as such.

We further believe that strengthening overarching principles would also support our suggestions above. This includes more discretion for undertakings to locate disclosures at one place instead of repeating these (e.g., centralised reporting on remuneration metrics or grievance mechanisms) or to locate disclosures in the sustainability report in general (e.g., the IRO-2 index). This is because it could also make the rigid structure of the sustainability report prescribed by the ESRS more flexible. Furthermore, the list of topics, sub-topics and sub-sub-topics according to ESRS 1.AR16 would not need to be read as a checklist.

Advantage of suggestion No. 9

Suggestion No. 9 is potentially most far reaching. It would allow undertakings to tie the content and presentation of sustainability information more closely to their actual organisation and business. This would eliminate the very complex and capacity-intensive exercise of converting an undertaking's individual understanding of its organisation and business into a rigid scheme which, in fact, does not fit in many cases. Undertakings in waves 1 and 2 could benefit from this simplification immediately.

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Suggestion No. 10: Strengthening interoperability with the ISSB global baseline

The ISSB and EFRAG have made great efforts to achieve interoperability between ESRS and the ISSB's global baseline. This ensures as far as possible that undertakings applying ESRS also comply with the IFRS Sustainability Disclosure Standards without significant additional effort. It is important to continue to bear this in mind in the future. On the one hand, the ESRS revision should not risk the high level of interoperability; in contrast, EFRAG and the European Commission as well as the ISSB should make every effort to narrow the remaining gap between ESRS E1 and IFRS S2. In this context, it should be specifically considered by EFRAG how to reduce the E1 reporting requirements without damaging interoperability to IFRS S2.

The importance of interoperability extends beyond the level of an individual undertaking seeking to comply with the provisions of both ESRS and the ISSB's sustainability disclosure standards (SDS). It also concerns the exemptions available to undertakings outside the EU that are required by national law to comply with IFRS SDS but are included in the consolidated sustainability report of a parent undertaking based in the EU.

We further believe that EFRAG should focus on shaping the ISSB's activities on amending the SASB standards in order to make the applicable in the international context and in connection with IFRS S2.

Advantage of suggestion No. 10

Suggestion No. 10 aims at an enhanced understanding of interoperability in a global context. International groups with a parent located in the EU but subsidiaries outside the EU should not be burdened with double reporting requirements for their subsidiaries. This would allow to avoid significant cost of double reporting for EU undertakings in the future. "Closing the gap" between ESRS E1 and IFRS S2 would further reduce the cost of reporting compliance.

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