aiaworldwide.com

T +44(0)191 493 0277
F +44(0)191 493 0278

E aia@aiaworldwide.com

Staithes 3, The Watermark,
Metro Riverside, Newcastle upon Tyne
NE11 9SN, United Kingdom

Mairead McGuinness
Commissioner for Financial
Services, Financial Stability
and Capital Markets Union,
European Commission

4 August 2022

Dear Commissioner McGuinness,

AIA Response to the EFRAG Public Consultation on the First Set of Draft ESRS

The Association of International Accountants (AIA) appreciates the opportunity to provide comments on the public consultation on the first set of draft European Sustainability Reporting Standards (ESRS). In submitting our response we have collaborated with other members of the European Federation of Accountants and Auditors for SMEs (EFAA), of which AIA is a member, with particular input from the Accounting, Assurance and EU Professional Regulation Expert Groups.

AIA is a leading professional body for accountants with a long-standing reputation for excellence in professional education and a dynamic global membership. Our members are recognised, respected and regulated.

AIA is a Recognised Qualifying Body (RQB) for statutory auditors in the UK and regulated by the Financial Reporting Council (FRC). AIA is a Prescribed Body under the Companies (Auditing and Accounting) Act 2014 in the Republic of Ireland. AIA's professional qualification has been independently assessed by the UK National Information Centre (UK ENIC, formerly NARIC) for global qualifications and skills as comparable to Level 7 on the Regulated Qualifications Framework.

The European Federation of Accountants and Auditors for SMEs (EFAA) represents accountants and auditors providing professional services primarily to small and medium-sized enterprises (SMEs) both within the European Union and Europe as a whole. Constituents are mainly small practitioners (SMPs), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g., audit, accounting, bookkeeping, tax, and business advice) to SMEs. EFAA represents 15 national accounting, auditing, and tax advisor organisations with more than 380,000 individual members.

Basis for Our Response

Many SMEs, and the SMPs supporting them through the provision of advisory, accounting and assurance services to them, stand to be impacted directly or indirectly, by the CSRD and EFRAG's ESRS. Our response is focused on the impact and implications for SMEs and SMPs. And our response is principle-based. We respond only to those sections and questions of the survey most relevant to our constituents and on which we have an informed view. Accordingly, you will see we have responded to Section 1A (all questions), Section 1B (all questions), Section 1C

(Q38), and Section 2 (all questions). In this cover letter we highlight our main points.

Sustainability

EFAA for SMEs believes sustainability - and climate change in particular - to be the most important issue and challenge of our time. We welcome the Green Deal. We welcome the commitment and ambition of its architects. And we welcome the Corporate Sustainability Reporting Directive (CSRD)'s embrace of SMEs. Sustainability is not just relevant to large companies. Collectively SMEs account for the majority share of private sector sustainability impact. So, they cannot, they must not, be left behind or ignored. Accordingly, EFAA welcomes the CSRD and its intent. And we welcome, in principle at least, the development of ESRS.

The pace of change is unprecedented. Sustainability reporting has emerged from the shadows into the spotlight, from margin to mainstream, in a fraction of the time financial reporting developed. And this type of reporting is, arguably, more complex, more controversial, more contentious, than financial reporting. We feel that the pace of change is too fast. We need to walk before we run. We need to prioritize and phase in while ensuring proportionality and scalability.

Due Process

We have reservations around due process. While we understand the need for some urgency, and that deadlines are to some extent determined by EU politicians and regulators, as manifested in the final CSRD, we feel that EFRAG has tried to do too much, too soon. EFRAG seems to be attempting in the first set of ESRS to have 'state of the art' standards – as perfect, technically rigorous, and comprehensive as they can make them within the tight time constraints imposed by the CSRD. We much prefer, and advocated for it to no avail, the 'think small and simple first' approach to standard setting, gradually building in the necessary complexity and comprehensiveness in due course. This would have lent itself to better due process. It would have given those less well equipped to respond in full to complex public consultations like this, such as SMEs and SMPs, the time to properly evaluate the proposals.

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Proportionality

The structure and articulation of the cross-cutting ESRS appear to support the coverage of CSRD topics and reporting areas. However, we have serious doubts as to whether the draft ESRS adequately reflect the final text of the CSRD with respect to SMEs 'caught' in the value chain.

While we are concerned not to overburden companies within direct scope of the CSRD, including listed SMEs and other large companies that are not presently within the scope of the NFRD, our primary concern is the indirect impact of new reporting requirements on unlisted SMEs that are in the value chain of companies within scope. We fear that these SMEs will be asked to supply extensive sustainability information, by way of reports or the completion of questionnaires, that will be difficult and costly to supply, if not impossible anytime soon.

While it is important SMEs become more sustainable, it is vital we do not overburden them. SMEs, and the SMPs supporting them, need time, resources, and access to the tools that will enable them to manage their own sustainable transition as well as supply the necessary data to companies in the large companies in their value chain. We are, therefore, encouraged to see the addition of Article 29b Sustainability reporting standards for SMEs which states:

> *"2b. Standards shall also take account of the difficulties that undertakings may encounter in gathering information from actors throughout their value chain, especially from those which are not obliged to report sustainability information pursuant to Article 19a or 29a of this Directive and from suppliers in emerging markets and economies. Standards shall specify disclosures on value chains that are proportionate and relevant to the scale and complexity of the activities, and the capacities and characteristics of undertakings in value chains, especially those of undertakings that are not subject to the sustainability reporting obligations of Articles 19a or 29a of this Directive. Standards shall not specify disclosures that would require undertakings to obtain information from small and medium-sized undertakings in their value chain that exceeds the information to be disclosed according to the sustainability reporting standards for small and medium-sized undertakings referred to in Article 29c."*

We believe the draft ESRS fail to meet the test of proportionality and relevance as the CSRD describes. Moreover, the SME standard will likely not be ready until 2023. This warrants an urgent solution. As a temporary, or more permanent, measure the information required could be aligned with that in the standard for unlisted SMEs that might be ready in time.

We eagerly await the outcome of the cost-benefit analysis which includes a survey that aims to collect the inputs to determine the costs and benefits for undertakings in the value chain of undertakings with a requirement to prepare a sustainability report. We anticipate this will provide evidence in support of EFRAG making modifications, in particular simplifications to achieve proportionality, to the draft ESRS.

Materiality

We believe there is a need for considerable simplification of materiality and its application in the ESRS. Presently it is far too complex and burdensome for larger undertakings with some familiarity with sustainability reporting, let alone smaller undertakings, first-time reporters, and SMEs in the value chain. We suggest that the materiality assessment be performed at the topic, or sub-topic level, rather than at individual impacts of DR. This will provide more useful information. We also believe there is a need for more guidance, including illustrative examples, for materiality, presented either in the application guidance section or in a separate guidance document.

If the materiality assessment is done properly then it will render the rebuttable presumption redundant. The rebuttable presumption is burdensome. Undertakings will have to report, or else provide reasons and "reasonable and supportable evidence" for not reporting, for many immaterial DR. This burden will also cascade down on smaller undertakings in the value chain. Hence, it will fail to support relevant, accurate and efficient documentation of the results of the materiality assessment. It needs to be eliminated.

In its place we suggest having a limited set of mandatory material sustainability DR, for DR that are indeed material for all, or the large majority, of companies across all sectors (e.g., carbon emissions), supplemented by a longer list of voluntary or optional DR that the undertaking can consider as part of the materiality assessment. We also suggest EFRAG consider using the undue cost or effort exemption for specific requirements, a concept that has proven effective in the IFRS for SMEs, for specific DR.

Reporting Boundary and Value Chain

We are pleased that the CSRD has 'capped' value chain information to what is to be required by the sustainability reporting standard for listed SMEs. However, it would be even better if, the CSRD permitting, the information could be capped at what is outlined in the standard under development for unlisted SMEs (see below). We also appreciate the introduction of value chain transition provisions in Article 19 a, (3) which states:

> *"For the first three years of the application of this Directive, in the event that not all the necessary information regarding the value chain is available, the undertaking shall explain the efforts made to obtain the information about its value chain, the reasons why this information could not be obtained, and the plans of the undertaking to obtain such information in the future."*

We welcome the possibility of undertakings making widespread use of approximations to avoid overburdening unlisted SMEs with requests for information that will prove costly for them to provide. In many, if not most, instances approximations will provide information that is sufficient. We suggest EFRAG leave it for undertakings themselves to determine how best to get information from their value chain, whether by direct request, approximations, or some other way. Approximations ought not be 'last resort' method, only for use when it is impractical for them to get it directly, but rather the preferred method in many cases. Guidance may also be necessary on how to develop the approximations.

EFRAG might also consider phasing-in the value chain information covering, say, in the first three years through to the first review of the ESRS only those undertakings under the control of the in-scope undertakings. This would allow undertakings, especially smaller ones, time to build the capacity to capture the required data to satisfy requests from in scope undertakings. This phase-in could be based on levels of control and influence the undertaking exercises over undertakings in its value chain – full control, influence and other.

ESRS could be simplified even further by deferring the requirement for value chain disclosures until the ESRS are first reviewed. Finally, we suggest EFRAG consider using the undue cost or effort exemption, commonly used in the IFRS for SMEs, for value chain reporting for all or some specific DR.

Prioritisation and Phasing-In

All the sustainability topics and subtopics addressed by ESRS are important and equally deserving. Some topics, however, are more urgent than others and / or more feasible to report on. The CSRD does not mandate comprehensive disclosure for all topics from the outset. This gives EFRAG much latitude to prioritize and phase-in. While we support coverage of all sustainability topics in core ESRS, we believe prioritization and phasing-in is essential. We believe climate change (ESRS E1) is the most urgent topic and as such demands to be prioritized and phased-in ahead of other topics. We might start with the most important DR for the largest companies in all sectors, then gradually adding DR within each ESRS, and finally require value chain disclosures.

We suggest phasing in over a period of three years as many companies, especially the smaller undertakings within scope of the CSRD, first time reporters and those in the value chain, will need time to build the capacity to report.

Interoperability with Global Standards

While we support the development of ESRS, as these are tailored to the needs of European economy and society, we believe global harmonisation to be desirable. As such we support the development of a global baseline by the International Sustainability Standards Board (ISSB) line to accommodate regional variations, provided they align in all fundamental respects. As such we support the development of a global baseline by the International Sustainability Standards Board (ISSB) and support IFAC's position as set out in its draft responses to the sustainability-related disclosures consultation and the climate-related disclosures consultation. We believe that this global baseline must be sufficiently flexible and generic to allow for regional standards like ESRS. Global and regional standards such seek to converge as far as possible through a process of co-construction and by pursuing those standards that are most developed and where there is the greatest consensus. We also believe that, as far as possible, ESRS should be no more burdensome than their ISSB equivalents. Departures from the global baseline should only be justified to ensure ESRS conform with prevailing EU law and agreed policy objectives.

Sustainability Standards for SMEs

It is clear that a 'one size fits all' approach to standards does not work well for SMEs as they are generally too complex to have a meaningful impact and therefore ineffectively applied. The CSRD, which stands to impact the millions of unlisted SMEs not within direct scope of the directive through the value chain, makes it even more important to have applicable sustainability reporting standards for SMEs. Such standards would also encourage voluntary reporting by SMEs.

We therefore look forward to the development, as soon as practicable, of sustainability reporting standards for SMEs, as envisaged by Article 29c of the CSRD. We understand EFRAG plans to issue as part of set 2 of ESRS SME standard(s) in late 2023. We believe this is too late. Hence, we strongly encourage EFRAG to adopt the sustainability reporting standard for unlisted SMEs that has been developed by Cluster 8 - SMEs of the former EFRAG PTF-ESRS. This draws on the Nordic Sustainability Reporting Standard. EFRAG may have to develop two separate standards – a mandatory one for listed SME and a voluntary for other SMEs – or else a modular standard with a 'core' module applicable to all SMEs. Whatever approach is taken we hope that Cluster 8's proposal is recognized as providing information sufficient to satisfy requests coming through the value chain.

We greatly appreciate this opportunity to share our points of view and look forward to supporting you.

Yours sincerely,

David Potts
Director of Operations

THE ASSOCIATION OF INTERNATIONAL ACCOUNTANTS

Consultation Response

ESRS Exposure Drafts issued by EFRAG

July 2022

Executive Summary

Basis for our response

Many SMEs, and the SMPs supporting them through the provision of advisory, accounting and assurance services to them, stand to be impacted directly or indirectly, by the CSRD and EFRAG's ESRS. Our response is focused on the impact and implications for SMEs and SMPs. And our response is principle-based. We respond only to those sections and questions of the survey most relevant to our constituents and on which we have an informed view. Accordingly, you will see we have responded to Section 1A (all questions), Section 1B (all questions), Section 1C (Q38), and Section 2 (all questions).

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AIA Response: EFRAG Sustainability Reporting Board Consultation Survey

Submitted in collaboration with the European Federation of Accountants and Auditors for SMEs (EFAA).

Question 1: in your opinion, to what extent do the structure and articulation of cross-cutting and topical standards adequately support the coverage of CSRD topics and reporting areas?

To a large extent with some reservations.

The structure and articulation of the cross-cutting ESRS appear to support the coverage of CSRD topics and reporting areas. However, we have serious doubts as to whether the draft ESRS adequately reflect the final text of the CSRD with respect to SMEs ‘caught’ in the value chain.

While we are concerned not to overburden companies within direct scope of the CSRD, including listed SMEs and other large companies that are not presently within the scope of the NFRD, our primary concern is the indirect impact of new reporting requirements on unlisted small and medium-sized enterprises (SMEs) that are in the value chain of companies within scope. We fear that these SMEs will be asked to supply extensive sustainability information, by way of reports or the completion of questionnaires, that will be difficult and costly to supply, if not impossible anytime soon.

While it is important SMEs become more sustainable, it is vital we do not overburden them. SMEs, and the SMPs supporting them, need time, resources, and access to the tools that will enable them to manage their own sustainable transition as well as supply the necessary data to companies in the large companies in their value chain. We are, therefore, encouraged to see the addition of Article 29b Sustainability reporting standards for SMEs which states:

> “2b. *Standards shall also take account of the difficulties that undertakings may encounter in gathering information from actors throughout their value chain, especially from those which are not obliged to report sustainability information pursuant to Article 19a or 29a of this Directive and from suppliers in emerging markets and economies. Standards shall specify disclosures on value chains that are proportionate and relevant to the scale and complexity of the activities, and the capacities and characteristics of undertakings in value chains, especially those of undertakings that are not subject to the sustainability reporting obligations of Articles 19a or 29a of this Directive. Standards shall not specify disclosures that would require undertakings to obtain information from small and medium-sized undertakings in their value chain that exceeds the information to be disclosed according to the sustainability reporting standards for small and medium-sized undertakings referred to in Article 29c.*”

We look forward to the development, as soon as practicable, of sustainability reporting standards for SMEs, as envisaged by Article 29c of the CSRD. EFRAG may have to develop two separate standards - mandatory for listed SME and voluntary for other SMEs – or else a modular standard with a ‘core’ module applicable to all SMEs and a ‘more’ module with additional requirements for listed SMEs. We understand that Cluster 8 - SMEs of the former EFRAG PTF-ESRS, that developed the present ESRS, has developed a standard for unlisted SMEs. This draws on the Nordic Sustainability Reporting Standard. We fully support this and urge EFRAG to adopt this standard and use it as a standalone standard and / or as the core module of a ESRS for all SMEs.

We also welcome the 'capping' of value chain information to what is to be required by the sustainability reporting standard for listed SMEs. However, it would be even better if, the CSRD permitting, the information could be capped at what is outlined in the standard under development for unlisted SMEs.

We believe the draft ESRS fail to meet the test of proportionality and relevance as the CSRD describes. Moreover, the SME standard will likely not be ready until 2023. This warrants an urgent solution. As a temporary, or more permanent, measure the information required could be aligned with that in the standard for unlisted SMEs that might be ready in time.

We also appreciate the respite afforded by the CSRD in the introduction of value chain transition provisions in Article 19 a, (3) which states:

"For the first three years of the application of this Directive, in the event that not all the necessary information regarding the value chain is available, the undertaking shall explain the efforts made to obtain the information about its value chain, the reasons why this information could not be obtained, and the plans of the undertaking to obtain such information in the future."

We eagerly await the outcome of the cost-benefit analysis which includes a survey that aims to collect the inputs to determine the costs and benefits for undertakings in the value chain of undertakings with a requirement to prepare a sustainability report. We anticipate this will provide evidence in support of EFRAG making modifications, in particular simplifications to achieve proportionality, to the draft ESRS.

We elaborate on the reporting boundary and value chain and phase-in in our responses below.

Question 2: in your opinion, to what extent is the TCFD framework of reporting areas (governance, strategy, risk management and metrics/targets) compatible with the structure of the ESRS?

To a large extent with some reservations.

We notice structural differences but see no good reason for this. Hence, we urge closer alignment with the TCFD framework. In so doing ESRS will be more closely aligned with the IFRS Sustainability Exposure Drafts which are already fully aligned with TCFD framework.

Question 3: in your opinion, to what extent does the approach taken to structure the reporting areas promote interoperability between the ESRA and the IFRS Sustainability Exposure Drafts?

To a large extent with some reservations.

We appreciate the intense efforts being made to ensure interoperability of the ESRS and IFRS Sustainability Disclosure Standards. The final text of the CSRD, Article 29 (2) requires:

> "*...that the standards shall avoid disproportionate administrative burden on undertakings, including by taking account to the greatest extent possible the work of global standard-setting initiatives for sustainability reporting...*"

We understand that EFRAG has committed to closer alignment and is in dialogue with the ISSB to this end. We believe that this global baseline must be sufficiently flexible and generic to allow for regional standards like ESRS. Global and regional standards such seek to converge as far as possible through a process of co-construction and by pursuing those standards that are most developed and where there is the greatest consensus. We also believe that, as far as possible, ESRS should be no more burdensome than their ISSB equivalents. Departures from the global baseline should only be justified to ensure ESRS conform with prevailing EU law and agreed policy objectives.

We also encourage EFRAG to ensure interoperability with GRI as far as practicable. We note that

EFRAG is in ongoing dialogue with the GRI.

Question 4: in your opinion, have these European legislation and initiatives been considered properly?

No opinion.

We understand the PTF-ESRS went to considerable effort to ensure the draft ESRS properly factored in all relevant EU legislation and initiatives.

Question 5: are there any other European policies and legislation you would suggest should be considered more fully?

No comments.

Question 6: in your opinion, to what extent does the proposed coverage of set 1 adequately address CSRD sustainability topics?

To a large extent with some reservations.

As we state in our response to Q1 we are concerned that the ESRS are too burdensome especially for those new to this type of reporting, smaller undertakings, and the indirect impact of new reporting requirements on unlisted small and medium-sized enterprises (SMEs) that are in the value chain of companies within scope. We fear that these SMEs will be asked to supply extensive sustainability information, by way of reports or the completion of questionnaires, that will be difficult and costly to supply, if not impossible anytime soon.

While it is important SMEs become more sustainable, it is vital we do not overburden them. SMEs, and the SMPs supporting them, need time, resources, and access to the tools that will enable them to manage their own sustainable transition as well as supply the necessary data to companies in the large companies in their value chain.

We have yet to see how EFRAG plans to build proportionality into ESRS as the final CSRD requires and urge closer alignment with the IFRS Sustainability Disclosure Standards.

Question 7: in your opinion, to what extent does the proposed coverage of set 1 adequately address SFDR reporting obligations?

Fully.

Question 8: do you agree with the proposed three options?

No.

Question 9: would you recommend any other option(s)?

While we prefer the ESRS not prescribe the location of sustainability information within the MR, rather it be left to undertakings to decide and in any case XBRL digital tagging will ensure users can easily locate information, we note that the final text of the CSRD, Article 19a(1) states: "This information shall be clearly identifiable within the management report, through a dedicated section of the management report." This appears to mandate the first option. If the CSRD allows, then we prefer undertakings choose where to locate within the MR.

Question 10: in your opinion, to what extent do you believe that connectivity between the sustainability reporting and other parts of the management report has been appropriately addressed?

Fully.

No additional comments.

Question 11: in your opinion, to what extent does the incorporate of information in the Sustainability section by reference to other parts of the management report support cohesiveness throughout corporate reporting?

Fully.

No additional comments.

Question 12: in your opinion, to what extent do the requirements and provisions on how to include monetary amounts and other financial statement-related quantitative data into sustainability reporting support connectivity with the financial statements?

To a large extent with some reservations.

Connectivity is important but we are in the early stages of connecting and integrating sustainability and financial reporting and, therefore, practice will inevitably evolve.

Question 13: to what extent do you think that the principle of relevance of sustainability information is adequately defined and prescribed?

To a large extent with some reservations.

We suggest closer alignment with terminology in the IFRS Sustainability Disclosure Standards.

Question 14: to what extent do you think that the principle of faithful representation of sustainability information is adequately defined and prescribed?

To a large extent with some reservations.

We suggest closer alignment with terminology in the IFRS Sustainability Disclosure Standards.

Question 15: to what extent do you think that the principle of comparability of sustainability information is adequately defined and prescribed?

To a large extent with some reservations.

Although comparisons for the same company over time is likely to be feasible it will be extremely difficult for users to make comparisons between companies.

We suggest closer alignment with terminology in the IFRS Sustainability Disclosure Standards.

Question 16: to what extent do you think that the principle of verifiability of sustainability information is adequately defined and prescribed?

To a large extent with some reservations.

We urge EFRAG to consult with the IAASB to determine the ability of practitioners to obtain assurance on an entity's sustainability reporting prepared in accordance with the draft ESRS.

We suggest closer alignment with terminology in the IFRS Sustainability Disclosure Standards.

Question 17: to what extent do you think that the principle of understandability of sustainability information is adequately defined and prescribed?

To a large extent with some reservations.

We suggest closer alignment with terminology in the IFRS Sustainability Disclosure Standards.

Question 18: in your opinion, to what extent does the definition of double materiality (as per ESRS 1 paragraph 46) foster the identification of sustainability information that would meet the needs of all stakeholders?

To a large extent with some reservations.

While we recognize that CSRD essentially determines that double materiality is used for the ESRS it seems EFRAG has some latitude as to how it is articulated and described. Hence, we suggest the definition be simplified and more closely aligned with the GRI definition. It might be sufficient to simply states that:

> "*A sustainability matter meets therefore the criteria of double materiality if it is material from either the impact perspective or the financial perspective or both perspectives*".

We welcome reference to the European public good and wonder whether this ought to be more widely referred to throughout the ESRS.

Question 19: to what extent do you think that the proposed implementation of double materiality (as per ESRS 2-IRO 1, paragraph 74b(iii) and AG 61) is practically feasible?

To a limited extent with strong reservations.

We believe ESRS 2 IRO 1 is highly complex and demand considerable exercise of professional judgement making it difficult to implement, especially for smaller undertakings. Many first-time reporters will have had no experience with this materiality.

There is a need for considerable simplification, especially paragraph 74 (that requires disaggregation by country or by significant site or a significant asset). The disclosure requirement only needs to address the process and the outcome of the double materiality assessment. Furthermore, we suggest the materiality assessment be performed at the topic, or sub-topic level, rather than at individual impacts of

DR, to provide more useful information.

We believe there is a need for more guidance, including illustrative examples, for materiality, presented either in the application guidance section or in a separate guidance document.

Question 20: in your opinion, to what extent is the definition of impact materiality (as per ESRS 1 paragraph 49) aligned with that of international standards?

To a large extent with some reservations.

We support closer alignment with GRI standards and IFRS Sustainability Disclosure Standards.

Question 21: to what extent do your think that the determination and implementation of impact materiality (as proposed by ESRS 1 paragraph 51) is practically feasible?

To a limited extent with strong reservations.

Impact materiality is inevitably complex and qualitative. Extending the boundary of what an undertaking is accountable for and must report on beyond the undertaking itself presents challenges not least gaining access to relevant and reliable data.

This information may be difficult for reporting entities to access and be confident in. This may become a particular issue where the reporting entity is commercially less powerful than suppliers and may create specific issues for the assurance of such statements, extending as it does the boundary of the information under consideration by the auditor. This may lead to limitations in the ability of entities to obtain assurance on their sustainability disclosure or may increase the cost of such assurances. This may be of particular concern to SMEs.

There is a need for considerable simplification, possibly by way of the materiality assessment being performed at the topic, or sub-topic level, rather than at individual impacts of DR. This will also provide more useful information.

We believe there is a need for more guidance, including illustrative examples, for materiality, presented either in the application guidance section or in a separate guidance document.

Question 22: in your opinion, to what extent is the definition of financial materiality (as per ESRS 1 paragraph 53) aligned with that of international standards?

To a limited extent with strong reservations.

We support closer alignment with IFRS Sustainability Disclosure Standards.

Question 23: to what extent do you think that the determination and implementation of financial materiality (as proposed by ESRS 1 paragraphs 54 to 56) is practically feasible?

To a large extent with some reservations.

We support closer alignment with IFRS Sustainability Disclosure Standards.

There is a need for considerable simplification, possibly by way of the materiality assessment being performed at the topic, or sub-topic level, rather than at individual impacts of DR. This will also provide more useful information.

We believe there is a need for more guidance, including illustrative examples, for materiality, presented either in the application guidance section or in a separate guidance document.

Question 24: to what extent do you think that the (materiality) rebuttable presumption and its proposed implementation will support relevant, accurate and efficient documentation of the results of the materiality assessment?

Not at all.

We believe that the materiality assessment, if done properly, renders the rebuttable presumption redundant.

We believe the most persuasive argument against its use is the risk of being a burden for undertakings that will have to report, or else provide reasons and "reasonable and supportable evidence" for not reporting, for many immaterial DR. This burden will also cascade down on smaller undertakings in the value chain. Hence, it will fail to support relevant, accurate and efficient documentation of the results of the materiality assessment.

Question 25: what would you say are the advantages of the (materiality) rebuttable presumption and its proposed implementation?

Undertakings that use IFRS will testify that the concept has proven to work, logical, and easy to apply. While this may be true for financial reporting, and for undertakings well versed in IFRS, we doubt it will be true for sustainability reporting and undertakings unfamiliar with IFRS.

Question 26: what would you say are the disadvantages of the (materiality) rebuttable presumption and its proposed implementation?

As we note in our response to Q24 we believe the disadvantages far outweigh the advantages. We believe the main disadvantage is the risk of excessive and unnecessary disclosure. Other disadvantages include the lack of consistency of reporting across undertakings and over time, arising from the inherent subjectivity in its application, and the risk of 'greenwashing' as undertakings seek to avoid disclosing material items for which they have a poor record.

Question 27: how would you suggest it can be improved?

We would prefer that the rebuttable presumption is eliminated.

In its place we suggest having a limited set of mandatory material sustainability DR, for DR that are indeed material for all, or the large majority, of companies across all sectors (e.g., carbon emissions), supplemented by a longer list of voluntary or optional DR that the undertaking can consider as part of the materiality assessment.

We suggest EFRAG consider using the undue cost or effort exemption for specific requirements, a concept that has proven effective in the IFRS for SMEs, for specific DR.

We believe there is a need for more guidance, including illustrative examples, for materiality, presented either in the application guidance section or in a separate guidance document.

Question 28: in your opinion, to what extent would approximation of information on the value chain

that cannot (practically) be collected contribute to the reporting of understandable, relevant, verifiable, comparable, and faithfully represented sustainability information?

To a large extent with some reservations.

Our primary concern is the indirect impact of new reporting requirements on unlisted small and medium-sized enterprises (SMEs) that are in the value chain of companies within scope. We fear that these SMEs will be asked to supply extensive sustainability information, by way of reports or the completion of questionnaires, that will be difficult and costly to supply.

While it is important SMEs become more sustainable, it is vital we do not overburden them. SMEs need time and access to the tools that will enable them to manage their own sustainable transition as well as supply the necessary data to companies in the large companies in their value chain. We are, therefore, encouraged to see the addition of Article 29b Sustainability reporting standards for SMEs which states:

> "2b...... *Standards shall specify disclosures on value chains that are proportionate and relevant to the scale and complexity of the activities, and the capacities and characteristics of undertakings in value chains, especially those of undertakings that are not subject to the sustainability reporting obligations of Articles 19a or 29a of this Directive. Standards shall not specify disclosures that would require undertakings to obtain information from small and medium-sized undertakings in their value chain that exceeds the information to be disclosed according to the sustainability reporting standards for small and medium-sized undertakings referred to in Article 29c.*

We look forward to the development, as soon as practicable, of sustainability reporting standards for SMEs, as envisaged by Article 29c of the CSRD. EFRAG may have to develop two separate standards - mandatory for listed SME and voluntary for other SMEs – or else a modular standard with a 'core' module applicable to all SMEs and a 'more' module with additional requirements for listed SMEs. We understand that Cluster 8 - SMEs of the former EFRAG PTF-ESRS, that developed the present ESRS, has developed a standard for unlisted SMEs. This draws on the Nordic Sustainability Reporting Standard. We fully support this and urge EFRAG to adopt this standard and use it as a standalone standard and / or as the core module of a ESRS for all SMEs.

We also welcome the 'capping' of value chain information to what is to be required by the sustainability reporting standard for listed SMEs. However, it would be even better if, the CSRD permitting, the information could be capped at what is outlined in the standard under development for unlisted SMEs.

We believe the draft ESRS fail to meet the test of proportionality and relevance as the CSRD describes. Moreover, the SME standard will likely not be ready until 2023. This warrants an urgent solution. As a temporary, or more permanent, measure the information required could be aligned with that in the standard for unlisted SMEs that might be ready in time.

And finally, we appreciate the respite afforded by the CSRD in the introduction of value chain transition provisions in Article 19 a, (3).

We welcome the possibility of undertakings making widespread use of approximations to avoid overburdening unlisted SMEs with requests for information that will prove costly for them to provide. In many, if not most, instances approximations will provide information that is sufficient.

We suggest EFRAG leave it for undertakings themselves to determine how best to get information from their value chain, whether by direct request, approximations, or some other way. Approximations ought not be 'last resort' method, only for use when it is impractical for them to get it directly, but rather the preferred method in many cases. Guidance may also be necessary on how to develop the approximations.

EFRAG might also consider phasing-in the value chain information covering, say, in the first three years through to the first review of the ESRS only those undertakings under the control of the in-scope undertakings. This would allow undertakings, especially smaller ones, time to build the capacity to capture the required data to satisfy requests from in scope undertakings. This phase-in could be based on levels of control and influence the undertaking exercises over undertakings in its value chain – full control, influence and other.

ESRS could be simplified even further by deferring the requirement for value chain disclosures until the ESRS are first reviewed.

Finally, we suggest EFRAG consider using the undue cost or effort exemption, commonly used in the IFRS for SMEs, for value chain reporting for all or some specific DR.

Question 29: what other alternative to approximation would you recommend in cases where collecting information is impracticable?

We suggest EFRAG consider using the undue cost or effort exemption, commonly used in the IFRS for SMEs, for value chain reporting for all or some specific DR. EFRAG might also want to consider deferring the requirement for value chain disclosures until the ESRS are first reviewed.

Question 30: in your opinion, to what extent will the choice of disaggregation level by the undertaking as per ESRS 1 paragraphs 72 to 77 contribute to the reporting of understandable, relevant, verifiable, comparable and faithfully represented sustainability information?

To a large extent with some reservations.

We are concerned as to complexity of the provision and leaving it for undertakings to choose.

We wonder whether disaggregation should be aligned with IFRS 8 segments, in so doing allowing for connectivity to financial reporting, and no more complex than that of IFRS S1.

Question 31: do you think it is relevant to define short-, medium- and long-term horizon for sustainability reporting purposes?

Yes, this is a reasonable approach to take. This is consistent with the time-horizons that entities are used to when reporting resilience and the comparability between the time-horizons will help with the adoption of such concepts. Time horizons are essential for ensuring reports are comparable over time and from one company to another.

Question 32: if yes, do you agree with the proposed time horizons?

No.

The proposed time horizons may not be suitable for all types of company or and all topics or subtopics. Hence, we suggest that it be left to companies to determine what they are and that the sector specific ESRS might wish to set horizons to allow for comparability across a sector.

Question 33: if you disagree with the proposed time horizons, what other suggestion would you make? And why?

The proposed time horizons may not be suitable for all types of company or and all topics or subtopics.

Hence, we suggest that it be left to companies to determine what they are and that the sector specific ESRS might wish to set horizons to allow for comparability across a sector.

Question 34: in your opinion, to what extent will DP 1-1 contribute to the reporting of understandable, relevant, verifiable, comparable and faithfully represented information on sustainability related policies?

To a large extent with some reservations.

We believe the DP is somewhat complex and will result in large quantity of information being disclosed and lack of comparability across undertakings. We urge EFRAG to simplify and standardize as far as possible.

Question 35: in your opinion, to what extent will DP 1-2 contribute to the reporting of understandable, relevant, verifiable, comparable, and faithfully represented information on sustainability-related targets and their monitoring?

To a large extent with some reservations.

We believe the DP is somewhat complex and will result in large quantity of information being disclosed and lack of comparability across undertakings. We urge EFRAG to simplify and standardize as far as possible.

Question 36: in your opinion, to what extent will DP 1-3 contribute to the reporting of understandable, relevant, verifiable, comparable, and faithfully represented information on sustainability-related action plans and allocated resources?

To a large extent with some reservations.

We believe the DP is somewhat complex and will result in large quantity of information being disclosed and lack of comparability across undertakings. We urge EFRAG to simplify and standardize as far as possible.

Question 37: is anything important missing in the aspects covered by the bases for preparation?

No.

Question 38: in your opinion, to what extent can ESRS 1 – General principles foster alignment with international sustainability reporting standards (in particular IFRS Sustainability Reporting S1 Exposure draft)?

To a large extent with some reservations.

We urge EFRAG to align ESRS as closely as possible with the IFRS Sustainability Disclosure Standards and GRI standards through a process of co-construction.

As we have not closely reviewed the ESRS we have responded 'No Opinion' to Q39-50.

Questions 39-50

No opinion.

Question 51: to what extent do you support the implementation of Application Provision AP1?

Fully.

Question 52: to what extent do you support the implementation of Application Provision AP2?

Fully.

Question 53: what other application provision facilitating first-time application would you suggest being considered?

Focus on fundamentals and their possible assurance. Where standards are extremely detailed, decide standard by standard which items are essential. Provide a two-stage timetable. We have some concerns about the cost of providing and assuring the information and whether it can be usefully compared from one company to another. We acknowledge that comparisons over time with the same company will be meaningful although we would like greater focus on changes the company has made from one year to the next, so that users/stakeholders can identify these together with some consideration of benchmarking against industry best practice. Consider also issues to do with smaller companies and new listings where the burden of compliance is more significant.

Question 54: for which one of the current ESRS disclosure requirements (see Appendix I) do you think implementation feasibility will prove challenging? and why?

We think these are both very important areas, but both are particularly challenging. The issue with Climate Change is the detail and the number of disclosures and with Workers in the Value Chain obtaining the information such that it is reliable.

The CSRD does not mandate comprehensive disclosure for all topics from the outset. Rather the CSRD gives EFRAG much latitude to prioritize and phase-in. While we support coverage of all sustainability topics in core ESRS, we believe prioritization and phasing-in is essential. We might start with the most important DR for the largest companies in all sectors, then gradually adding DR within each ESRS, and finally require value chain disclosures.

As we indicate in our responses to Q23-27 we propose eliminating the rebuttable presumption. We also support the phase-in of many, if not most, DR to allow undertakings, especially smaller ones and first-time reporters, the time, possibly three years, to define their targets and KPIs on material IROs.

As we indicate in our response to Q28 we welcome the CSRD capping value chain reporting to the information required by the standard for listed SMEs (though we would prefer that by the voluntary standard under development for unlisted SMEs) and the transitional provisions for value chain reporting. But we go on to suggest phasing-in value chain reporting according to the status of the undertaking in the value chain, starting with information from undertakings within direct control of the reporting undertaking, then moving onto undertakings over which the undertaking exerts influence, and then the rest.

While all sustainability topics and subtopics are important, climate change (ESRS E1) is the most urgent and as such demands to be prioritized and phased-in ahead of other topics.

A pervasive challenge is the specificity and granularly of DR across the topic specific ESRS. Many require a significant quantity of data, data which is not recently available to most undertakings and often will need to be collected from undertakings in the value chain.

We suspect the most challenging DR will largely be the environmental ones (especially ESRS E2, E3 and E5) due to current lack of established information systems to capture the necessary data, especially in smaller undertakings in scope and those in the value chain, and the lack of data in some sectors. The specific DRs that appear to be the most challenging include E2-6, E3-5, E5-4, and E5-5. And with their obvious implications for undertakings in the value chain we also foresee challenges for smaller undertakings fulfilling information requests from in scope undertakings for ESRS S2 DR such as S2-22 and S2-33.

Question 55: over what period of time would you think the implementation of such "challenging" disclosure requirements should be phased-in? and why?

Disclosures cannot just be delayed just because they are challenging, however we suggest phasing in over a period of three years as many companies, especially the smaller undertakings within scope of the CSRD, first time reporters and those in the value chain, will need time to build the capacity to report.

Question 56: beyond feasibility of implementation, what other criteria for implementation prioritisation / phasing-in would recommend being considered? And why?

As we indicate in our response to Q54 we see scope for prioritization and phase-in from three perspectives – materiality, reporting boundary and value chain, and ED content – and that the primary drivers are feasibility and the urgency of the sustainability topic or subtopic.

These standards are by necessity complex and extensive and therefore may meet with resistance from preparers who perceive them to be onerous – and not especially beneficial (in financial terms) to the entity. This risks de-minimus engagement and limited boilerplate disclosure and information which is not useful and fails to deliver the desired objectives of the proposed standards.

For SMEs who are not engaged with the reporting regime required for public listing, these standards may represent a significant uplift in reporting requirements and introduce extensive narrative elements into their reports which they are unfamiliar with. We therefore believe that a simplified standard for SMEs could be beneficial.

Question 57: please share any other comments you might have regarding ESRS implementation prioritisation / phasing-in

These comments are in addition to the survey response. We acknowledge that some comments may be addressed or clarified in the consultation document, but such is the detail of it is inevitable that occasional responses may contain some misapprehensions (albeit that may also indicate the need for clarification in a particular area). Although this document raises some issues it does not take anything away from the useful and incredibly complex attempt to bring together various regulations.

1) The notion of the need for transparency of information around the European Public Good is stated within the definition of information materiality. We absolutely agree that the impact that entities have on society and the planet requires that corporate accountability must be extended to these wider stakeholders. Within the sustainability report we believe that entities should make a statement regarding their contribution to public good with a summary of their positive and negative impacts upon that public good. This reflects the ideas in the Report on the Independent

Review into the Quality and Effectiveness of Audit (2019) authored by Brydon for the UK Government. This suggests that:

> *"The directors present an annual Public Interest Statement, which explains the company's view of its obligations to the public interest, whether arising from statutory, self-determined or other obligations, and how the company has acted to meet this public interest over the previous year. This statement would provide an opportunity for directors to articulate in a holistic way how the company they govern serves the wider public interest. This is not an invitation to provide an exhaustive summary of every legal duty that the company or its directors comply with, but rather a concise explanation by the directors of how they perceive the public interest in their company, and how they have taken measures to serve that interest over the previous year."*
>
> *At the start of the sustainability report we suggest that directors present a Public Good Statement explaining the company's view of its obligations around preserving public good and acting sustainably and summarises how this has been achieved during the year. This could act as an overview of significant challenges and progress and provide an articulation of the directors' perceptions of the entity's contribution to and impacts on that public good. This could serve as a mechanism to explicitly embed a common view of the purpose of sustainability reporting and therefore drive the acceptance of this change in accountability.*

2) We very much welcome the definition of information materiality as the "its capacity to meet the needs of the stakeholders of the undertaking, allowing for proper decision-making" and the corresponding supporting definitions of stakeholders as both affected stakeholder and users of sustainability reporting. We believe this will embed a normative engagement with stakeholder consideration beyond just stakeholders who can impact upon the company and represents the correct emphasis for sustainability accountability. We are supportive of moving away from a capital provider focus for materiality consideration and the instrumental engagement with wider stakeholders that this enables/ encourages. We recognise that this is a different focus from the materiality ideas currently posited by the prototype standards for sustainability from the IFRS Foundation work and believe that the ESRS approach is preferable and will lead to more meaningful accountability.

3) The overall approach to summarise disclosure requirements from multiple sources and provide a clear overall guide is helpful. The FT has recently reported the problems of fragmented regulation where companies and users are struggling to deal with diverging approaches (Mundy & Temple-West 2022). It is also vital that new standards are precise, and these Exposure Drafts are, for the most part clear. We appreciate the starting point was the EU CSRD proposal, but we wondered why greater use was not made of the Global Reporting Initiative (GRI) standards from 2016? For us that would have been the ideal starting point.

4) While the overall Cover Note is clear, the appendices are quite difficult to follow with the exception of the Acronyms and glossary of terms (VI). One issue is the objectives of each Appendix. Appendix II is much clearer than Appendix I in that the objectives are clearly stated at the start. The tables in the various appendices are impressive but may be off putting to readers trying to obtain an overview. We would suggest these Cover note appendices (other than main one and perhaps the glossary) appear much later in the document because they explain the work done/detailed workings rather than providing a necessary overall view. In short, as they appear

at the moment, they are quite off putting. It seems a bit like going into a car showroom and immediately being shown the detailed components of the engine.

5) A strength of these documents are the definitions provided. However, on occasion, some definitions of terms that are in common use are also provided. This seems quite unnecessary and detracts from the specific terms which do warrant a definition. We appreciate that different things can mean different things to different stakeholders but some of the definitions seem to be superfluous. Also, while the use of acronyms is sometimes necessary, it would facilitate understanding if the full title was always used in headings/sub-headings in the documents. The use of the term double materiality is used as (presumably) it appears in the draft EU directive (CSRD) but it is somewhat confusing and part of the definition seems different to that used in e.g. the ISFRS. Although it may be too late to change the double materiality term now, but we think multi-aspect or dual aspect materiality would be a better term.

6) Although it is arguable that all suggested disclosures are of importance in establishing sustainability, we would recommend a "focus on fundamentals". This would ensure that the appropriate guidance can be given and importantly auditors were able to attest to the reliability of the disclosures. The EDs represent a collection of possible disclosures that a sustainability report should contain. Potentially there will be a ranking of those so in the first year(s) of compliance, reporting organisations can focus on the most important or salient items. Further, in subsequent years we believe a key focus for the sustainability reports should be the changes from one year to the next particularly changes which specifically address products or processes with negative impacts (e.g. a company moving to electric vehicles or the discontinuation of a product that has been associated with negative environment impact or where undesirable issues within the value chain have come to light). Users would be able to see quickly what changes companies have made and why. We also support specific disclosures which relate to new business or new products. A key focus has to be on specific, reliable disclosures which replace the current greenwashing in this area which companies and their auditors can hide behind. It is also important to appreciate that companies will be required to comply with industry specific standards in the future adding considerably to their disclosure burden. For certain industries (e.g. the fashion and extractive industries) demonstrating sustainability is going to be incredibly challenging.

7) In view of the considerable requirements, in the early years it may be worth operating some standards on a "Comply or Explain" basis. We see that some of the later standards already utilise that approach (see, for example, paragraphs 16 and 27 of ESRS E4) with companies stating what they have not complied with, why they have not complied, and the arrangements being made to comply in future (by for example gathering any necessary extra data). If this is to be considered, we would suggest adopting a tabular approach which lays out very clearly how the disclosures should be provided. A useful part of the guidance notes is where they explain how to lay out disclosures. In the UK, the relatively unregulated approach to Governance using a "Comply or Explain" approach has resulted in disclosures being difficult to locate, both inadequate in their explanations and showing signs of obfuscation and under disclosing noncompliance. The early years of new regulation require careful assessment and overview by regulators. The belief that stakeholders or even shareholders will hold companies to account if they fail to provide adequate explanations, appears to be contradicted by years of disclosure (or lack of it).

8) For new listings we would encourage the adoption of a more flexible approach to allow the collection of data and so to not discourage companies from listing.

9) The guidance notes are useful in understanding the requirements especially where a table is provided with useful columns. At some point a sample/imaginary set of disclosures for some different businesses (different industries/services) would also be particularly helpful.

10) The need to engage SMEs is critical to the overall success of this reporting innovation. However, we see that this may be especially challenging and meet with some resistance – especially coming at a time of considerable economic turbulence and challenge. There is a risk that sustainability reporting is perceived as an onerous additional burden which is too complex and therefore is not engaged with meaningfully. As SMEs are not usually visible companies, many have not experienced the need to disclose their sustainability credentials within their statutory reporting and few will have engaged with assurance of this. The gap between the sustainability baseline of many SMEs to these standards is very significant and this will make their adoption difficult. We believe that the SME journey to such reporting needs to be broken down and supported through the provision of a detailed and realistic road map for sustainable reporting and the development of simplified SME Sustainability Standards should be considered.

The disclosures required are precisely written but ESRS1 (General Principles) and ESRS2 are quite wordy in places and could be usefully shortened. Some aspects are repeated e.g., ESRS 2 para 2 and 13 (ironically about companies repeating information).

ESRS 2 – Business card seems a strange term to use. Paragraph 5: We are not convinced that the reporting scope should be the same as in the Consolidated Financial Statements where some areas of the business might not be included. Paragraph 6: We prefer presentation options a) or b). We think c) might be less useful to readers and possibly harder to compare and we would suggest removing it as an option. “Non separable blocks” seem very jargonistic. In paragraph 23 would missing data indicate non-compliance? Possibly suggesting a “Comply or Explain” approach might be appropriate here. Paragraph 27 could be better worded and unfortunately hints at duplication (excepting sector specific information). Would paragraph 28 allow for a “not yet compliant disclosure”? Paragraph 47: Particularly useful would be information about how sustainability risks and opportunities have changed from one financial year to the next. This would require companies to genuinely evaluate changes and would help avoid repeating boilerplate information. Paragraph 50: Would it be simpler just to refer to governance bodies rather than administrative, management and supervisory bodies which seems to accord more with a multi-tier board?

A checklist summarising the 137 disclosure requirements would be useful. This would help companies identify where existing disclosures already meet the necessary requirements and identify areas where additional data needs to be gathered (or systems developed which generate that data) or where additional disclosures will be needed in future.

SFDR Principal Adverse Impact (PAI) indicators wrongly appears as Principle Adverse Indicators in places (e.g., Cover Note Appendix 1, paragraph 2).

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AIA has members working throughout the whole spectrum of the accountancy profession. Many of our members are at the top of the accountancy industry, from senior management to director level. Conversely, significant numbers of our members work in small and medium sized businesses (SMEs) and we strive to champion the importance of SMEs and their needs.

Further Information

The above replies represent our comments upon this consultation document. We hope that our comments will be helpful and seen as constructive. AIA will be pleased to learn of feedback, and to assist further in this discussion process if requested.

If you require any further information, please contact:

AIA Policy & Public Affairs Department
The Association of International Accountants
Staithes 3 The Watermark
Metro Riverside
Newcastle upon Tyne
NE11 9SN
United Kingdom

T: +44 (0)191 493 0269

E: consultations@aiaworldwide.com

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THE ASSOCIATION OF INTERNATIONAL ACCOUNTANTS