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Consultation on draft European Sustainability Reporting Standards

The Confederation of Swedish Enterprise, the Council for Swedish Financial Reporting Supervision, FAR (The Institute for the Accountancy Profession in Sweden) and Nasdaq Sweden support the current trend towards convergence of sustainability reporting standards and for greater coherence of corporate reporting. We fully acknowledge the pressing need to develop tools that will encourage and drive the investments needed to contribute to sustainable development, climate commitments and the implementation of Agenda 2030. A common reporting framework will be vital for increasing the coherence, consistency, and comparability of sustainability disclosures. To ensure that users receive relevant information while maintaining credibility and legitimacy among the business community, the requirements need to be both proportionate and practical. Therefore, the forthcoming ESRS (European Sustainability Reporting Standards) need to strike the right balance between comparability and consistency on one hand and proportionality and workability on the other.

Too wide-ranging and granular requirements that leave reporting entities and auditors with little guidance to determine materiality and boundaries of reporting, run the risk of turning the reporting process into an extensive compliance exercise while obscuring the sustainability information to the detriment of users. As the CSRD (Corporate Sustainability Reporting Directive) significantly expands the scope of compulsory sustainability reporting, most European entities that will comply with the ESRS are not currently subject to any non-financial reporting requirements (apart from the limited comments on environmental and social matters currently disclosed as part of the management report). This group of entities in particular needs a robust and feasible reporting framework, one that is capable of guiding them to the correct conclusions on what to report and that can work as a basis for an effective and proportional reporting process. We see the need for considerable improvements if the forthcoming ESRS is going to address those requirements.

Pressed time plan and lack of impact assessment

We are concerned that the broad extent of the draft standards, in combination with the restricted consultation period, will reduce the prospects for both the EFRAG (European Financial Reporting Advisory Group) and respondents to perform an adequate analysis and evaluation of the proposals, as well as conducting an appropriate impact assessment. We acknowledge that developing the draft ESRS has been a huge challenge for the PTF (Project Task Force), in particular given the restricted timeframe and the uncertainty regarding the specifics of the CSRD. It is therefore understandable that the PTF has not had sufficient time to consider ways of streamlining the text to make the ESRS more user friendly, avoid repetitions and, above all, develop workable reporting principles. However, given the magnitude of the reporting requirements under the ESRS, there is a need for a more thorough analysis going forward. It is therefore positive that EFRAG has chosen to field test the proposal.

Nevertheless, the duration of the current consultation period does not allow for an adequate evaluation of the draft standards. Furthermore, it is surely unacceptable that an impact assessment of the application of the draft ESRS has not been completed as yet. Given the extended scope of the CSRD, and the magnitude of the draft standards that also will affect a large group of entities currently not subject to any non-financial reporting requirements, it is impossible to evaluate the proportionality of the draft ESRS without such an impact assessment. We strongly recommend that EFRAG extend the consultation period of the ESRS to allow for both the impact assessment to be completed and for a better and more thorough evaluation of the draft standards.

Convergence and coherence with other reporting requirements and frameworks

Simplification through convergence of differing reporting frameworks is one of the key aims behind the CSRD. Entities that conduct their business on, and receive funding from, global markets require a common international reporting framework. Ultimately, therefore, a global set of sustainability reporting standards is what the EU should be striving for. The ISSB has - in a very short period of time - demonstrated that they are the standard setters capable of providing such a reporting framework.

However, until a European reporting framework is capable of converging with the ISSB standards, many reporting entities will need to comply with both the ISSB and ESRS standards, which is far from ideal. To facilitate this, a building-block approach would be preferable. This will require EFRAG to maintain a close dialogue with the ISSB and to continuously provide reporting entities with clear guidance on how the ESRS relates to global standards.[1] Any discrepancies should be avoided and when added, duly warranted.

This building-block approach will also be relevant when adjusting to financial reporting requirements. Several reporting areas in the draft ESRS overlap with existing disclosures in the annual accounts. Among the most obvious examples are the business overview, with disclosures on the number of employees, the breakdown of revenue and the information requirements on corporate governance. If implemented, such intersections between the ESRS and existing reporting requirements would put unnecessary extra weight on the already-heavy reporting burden that the CSRD will imply for those reporting entities that fall within its scope. Even where the ESRS allows the inclusion of such disclosures by reference to the sustainability report, it places the responsibility squarely upon reporting entities and their auditors to evaluate the extent to which the potential reporting areas overlap and in which aspects they may theoretically differ. Separate assurance opinions for the sustainability report and the financial statements (whether voluntarily or compulsory) would further increase the probability of conflicting conclusions over the equivalence of the reporting requirements.

Furthermore, similar, or repetitive disclosures in the sustainability report and the financial statements risk obscuring the information and reducing its understandability for users. A user cannot be expected to have full knowledge of the various aspects of the reporting frameworks that may result in potential discrepancies. Such differences therefore run the risk of being misinterpreted as misstatements or inconsistencies, if not explained thoroughly by the reporting entity. This in turn may increase the volume of an already substantial report.

Clearly, the best way to improve alignment and coherence with financial reporting requirements is to avoid including, in the ESRS, disclosures that are provided as a cause of existing rules, for example headcount. If disclosures are added to the ESRS that are similar in nature (but not interchangeable) to existing requirements, it should be made clear in which of those aspects the additional information

[1] In this context, the mapping of the draft ESRS to the ISSB draft standards and the TCFD framework that EFRAG provided along with the consultation package has proved extremely helpful. As GRI is the voluntary framework most commonly used on the Swedish market, a similar table, which compares GRI to ESRS, would be of considerable assistance when implementing ESRS.

differs from that already available, as well as exactly what additional information the reporting entity is required to add and why.

Proportional reporting requirements for the benefit of both preparers and users

The vast majority of companies that will report under the ESRS are not currently subject to a non-financial reporting requirement. Generally speaking, these entities lack the available resources, processes, and competence to implement a reporting framework of this magnitude. In addition, many entities that do provide a sustainability report, are not prepared to process nor disclose information at this scale and level of detail. Therefore, reporting entities need better and more practical tools to understand and assess the scope of the reporting requirements. The current principles in the draft standards are simply too general and overly inclusive in their scope, leaving reporting entities with little choice than to simply comply with the full set of ESRS disclosures. Left unaltered, the draft ESRS would be considered disproportionate and not aligned with the objectives of the EU Better Regulation agenda. The sustainability reporting process would be reduced to a complicated compliance exercise and cause the reports to overflow with irrelevant information, boilerplate disclosures and extensive disclaimers, with no benefit to users. Such an outcome would be contradictory to the aim of the CSRD.

Therefore, there is an urgent need to develop workable tools to dimension the scope of the requirements to the activities and size of the reporting entity. We consider that the best method of achieving this is to develop more workable principles for materiality assessments aimed at the information needs of users of sustainability reports. Furthermore, the extensive number of introspective disclosures that require detailed descriptions of internal processes and assessments need to be reduced.[2] Such requirements tend in practice to lead to boilerplate uninformed disclosures that are of little information value for users. Finally, the CSRD will apply to a wide range of reporting entities, which differ fundamentally in terms of the scope of their operations, from large multinationals to relatively small entities, operating on a limited scale on local markets. There is a need for practical and workable thresholds within the ESRS for ensuring that the scope of the reporting requirements is relevant to the size of the entity.

Workable criteria for assessing materiality

The CSRD is based on a double materiality concept, which should be applied to determine the sustainability matters that should be reported and the disclosures that should be provided. In practice, the double materiality concept will not only act as a central guiding principle for reporting entities, but also for assurance providers and users of sustainability reports. To make it at least reasonable feasible for these parties to reach the same conclusion regarding what information the reporting entity shall disclose, the ESRS need to provide a robust and clear common ground for how the concept of double materiality should be defined and applied in practice.

However, the principles proposed for determining double materiality in the draft ESRS are vague, and the reasoning behind them is difficult to follow.[3] We are particularly concerned with the draft principles

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[2] The proposed disclosures that address internal processes and assessments in ESRS 2 and the topical standards are both extensive and overly granular. One area where the proposed disclosures are excessive and risk becoming boilerplate with questionable information value is in the materiality assessment of impacts, risks and opportunities in ESRS 2 (IRO 1-3). In particular, this is the case when considering the provisions that are included in the Application Guidance. The status of the Application Guidance is not clear, but the general wording indicates that that it should be considered as part of the mandatory requirements.

[3] For example, according to paragraph 48 in ESRS 1, the terms ‘significant’ and ‘material’ have the same meaning when referring to impacts, risks and opportunities in ESRS. In the following paragraph, it is stated that a sustainability matter is material from an impact perspective if it is connected to actual or potential significant impacts by the undertaking on people or the environment over the short-, medium- or long term. Such circular reasoning leaves the reporting entity with little or no logical guidance in determining which matters to report from an impact point of view.

The vague outline of impact materiality is combined with a rebuttable presumption that all the sector-agnostic and sector-specific ESRS are material for reporting entities, unless reasonable and supportable counterevidence is presented. However, the draft ESRS remains silent on which facts or circumstances that would qualify as counterevidence. Thus, as the principles in the ESRS fail to provide adequate tools and guidance for the assessment of what information to report, it is left to the undertaking to develop its own criteria and thresholds for determining materiality.[4] This puts a heavy burden on reporting entities. Given that such criteria must also be agreed upon by assurance providers and (preferably) users of sustainability reports, many entities will inevitably be led to conclude that they should comply with the full set of ESRS. This will risk turning the reporting process into a compliance exercise and creating an overload of less relevant information in the sustainability reports.

The lack of a workable definition of materiality will not only place an unnecessary burden on preparers, it will also obfuscate the information in the sustainability reports, making it difficult to determine what are actually the crucial sustainability matters for the reporting entity. The ability for users to identify crucial matters from the sustainability report will be further undermined by the statement in the draft ESRS that says that those disclosures that are complied with should be regarded as confirmed as material by the reporting entity. Thus, if an entity includes a disclosure in its sustainability report, according to the ESRS the information should be regarded as material. Yet the actual cause behind the disclosure may very well be the lack of adequate guidance for assessing and verifying that the matter is insignificant for the reporting entity. This will undermine the meaning of the materiality concept, to the detriment of both preparers and users of sustainability reports.

The vague nature of the double materiality concept is also an issue of legal certainty. The ESRS are to be adopted as Delegated Acts. This, together with the assurance requirement, places a heavy demand on workable definitions and a clear delimitation of the scope of the reporting requirements. Thus, the difference between a voluntary framework - such as GRI, which has a similar approach to materiality as the draft ESRS - and compulsory legal requirements adopted as Delegated Acts should be acknowledged. This needs to be seriously taken into consideration in the further development of the ESRS.

We are convinced that it is possible to provide a clearer demarcation on the scope of the sustainability reporting requirements in the ESRS. If reporting entities are expected to be able to determine principles and thresholds for the determination of materiality, as suggested by the draft ESRS, it should be possible for EFRAG to provide workable guidance on how to go about this. The severity and likelihood dimensions, as referred to in the draft ESRS, are insufficient. This due to the fact that they require assessments of future events that are difficult to make and are subjective in nature (for example, the implied mutual ranking of the severity of potential impacts).

The reporting boundaries and delimitations of impact materiality is particularly crucial for determining impacts within the reporting entities value chain. The degree of ambiguity over direct and indirect consequences of the reporting entities actions within the value chain will be the main driver behind the much-debated trickledown effect, and the unintended administrative burden that the CSRD will lay on SMEs. The lack of delimitations in this area will also be a major cause of double counting and will thus have an impact on the quality of sustainability data.

The determination of materiality should also be delimited to the information needs of the users of sustainability reports. The current vague references to stakeholders and general transparency requirements are insufficient to determine clearly what issues an entity should report on. The

[4] Paragraph 43, 58 and 62 in ESRS 1 states that it is up to the reporting entity to determine thresholds and criteria for the assessment of materiality.

sustainability report is a form of communication and as such, it needs to be designed with the needs of the recipients of the information (i.e., the end users) as the focus. These users are assumed to have an interest of sustainability information, which may include how the activities of the entity affect stakeholder groups. However, when outlining the information in the report, the entity cannot take the interests of a group that is not expected to take part of the information in the report into account. As it stands, the proposed definition of stakeholders - which includes anyone whose interests are, or may be, affected either positively or negatively - increases the scope of the materiality assessment to such an extent that the objective behind the shared classification is lost.

Focusing on the information needs of users, and in particular users on the capital market, would not necessarily run contrary to the double materiality principle. The range of sustainability data that is presently requested and collected by large asset managers and other leading actors on the global capital markets tend to coincide with the type of data that attracts attention from other stakeholders over time. The differences in their respective interests should thus not be overestimated. Thus, to build confidence and comparability and provide reporting entities with a realistic prospect of executing an effective materiality assessment, the information needs of users need to be prioritised.

Characteristics of information quality and the auditor's opinion

The characteristics of information quality stipulated in the draft ESRS are familiar concepts, well established in accounting theory and existing financial reporting frameworks, such as IFRS. The concepts should serve not only as guidance for reporting entities and assurance providers, but also for standard-setters. The reporting framework needs to be outlined in such a way that a reporting entity (at least under normal circumstances) can be expected to provide reports that fulfil the principles of information quality. However, reporting based on the draft ESRS implies entity-specific principles and thresholds, a significant degree of estimation and assessment as well as highly uncertain assumptions around future events. This will make it unclear for reporting entities as to whether they are meeting, for example, the reliability, completeness, and verifiability criteria. It may make it more difficult still to determine whether those criteria have been met from an auditor's perspective.

We fear that the difficulty in obtaining and disclosing the information that fulfils the quality requirements in the draft ESRS may - at least in the initial few years - lead to an increased number of audit reports with qualified opinions (adverse opinions). This in turn may impact the ability of reporting entities to access finance. If such difficulties arose as direct consequence of the design of the reporting framework (rather than through actual deficiencies in the management of sustainability matters), it would be to the detriment of the legitimacy of the ESRS among both the preparers and the users of sustainability reports. Considering the level of importance and severe nature of the issues at hand, we believe that it is crucial to build and maintain trust and confidence in the reporting framework. A framework that is inconsistent with its own principles of information quality will inevitably undermine the endeavour.

The concerns raised over reporting based on the draft ESRS from the auditor's perspective also applies to the supervision of sustainability reports. A key motivation behind the enforcement of non-financial reporting is to maintain trust and confidence in the reporting framework and to foster a uniform application. However, if the disclosure requirements do not enable supervisory authorities to assess the extent to which the reporting entity is compliant, the goal of the supervision will be undermined.

Risk of delay of the reporting process

Complying with the extensive disclosure requirements in the draft ESRS, converting it into an electronic format and auditing the information will be a time-consuming process. The period between the closing and the publication of the annual report is therefore likely to increase substantially for entities involved. This will have a significant negative impact of the timeliness of the financial information, which is an essential characteristic of information quality. It will also create significant practical problems for reporting entities, as the extended time between the closing date and the release of the annual report increases the chances of events occurring after the reporting date, and thus the need for adjacent adjustments. Listed entities have therefore sought to shorten the period between closing and publishing to ensure timeliness and relevance of the report and to reduce the likeliness of unforeseen events and adjustments late in the reporting process. This timeliness aspect needs to be considered by EFRAG in its future deliberations. One apparent measure is to provide reporting entities and assurance providers with more practical tools and principles for determining materiality, enabling a more efficient process, a reduction in the volume of information and thus timelier reporting.

Topical standards

As already set out, the proposed principles of materiality will be challenging for reporting entities to apply in practice. Thus, reporting entities may conclude that they should comply with all topical ESRS. Further, the topical standards on Governance, Business Conduct, Own Workforce and presumably, Climate Change cover such sustainability matters that are relevant for all reporting entities. These standards will, therefore, be regarded as to all intents compulsory in practice. We have not yet had time for a comprehensive evaluation of the draft topical standards, but nevertheless we remain concerned by the level of detail in the proposed disclosures. The extensive level of information that reporting entities are expected to provide based on the requirements in, for example, the Own Workforce standard and its associated application guidance, is out of proportion. These requirements are particularly concerning as this standard will, in practice, be mandatory (provided that the reporting entity has employees). Furthermore, some of the information entities are expected to disclose under the requirements in the topical standards (for example, the ESRS on Business Conduct) may be of a highly sensitive nature or may be in opposition to capital market regulations (for example, some of the future-oriented information). Those aspects of the transparency requirements need to be closely into considered by EFRAG in its future deliberations.

Summary proposals for the work going forward

We understand that EFRAG has had limited time at its disposal for finalising the draft ESRS, and that the best available approach has been to combine existing reporting frameworks into one. However, convergence of sustainability reporting also requires streamlining and prioritisation among the vast amount of information demands. To attain a workable and proportionate reporting framework, the future focus must therefore be on rationalisation and simplification.

In order to avoid information overload and undermining the relevance of sustainability reports, the guidance on how to apply the double materiality concept needs to be developed further. Reporting entities, assurance providers, supervisory authorities and users of sustainability reports need clear and common ground that will enable them to agree on the scope, the boundaries, and the relevant content of the disclosures. In the deliberations ahead, the difference in information needs and interests of investors and other stakeholders should not be exaggerated. There is a clear correlation between sustainability impacts and enterprise value.

In addition, EFRAG needs to consider how the topical standards corresponds mutually and to reconsider the granularity of some of the topical standards. The application guidance should be regarded as a tool to facilitate the application of the ESRS, and not contain additional disclosure requirements. Certain disclosures included in the topical standards may be better suited as part of the sector standards. Another effective method of simplifying the reporting framework is to apply a 'building block' approach and avoid duplications and recurring disclosures. To the greatest extent possible, EFRAG should facilitate the process for entities that wish to, or are required to, apply the ISSB standards.

Finally, to compromise on information quality in the interest of time will be of little benefit to users and preparers of sustainability reports. We therefore propose that the process is extended in future, starting with the consultation period for the draft ESRS. We also recommend that EFRAG adopts a phasing in approach to the reporting standards, thus allowing smaller entities time to adjust to the extensive reporting framework, to develop reporting processes and systems to deal with the new requirements.[5] Overall, this approach would allow for better evaluation of the proposal, the completion of the impact assessment and for interested parties to provide EFRAG with more-informed feedback. Such an approach would also allow time for improved convergence with the upcoming ISSB standards. To improve the quality of, and ensure support for, the future reporting framework, it would be better to have an extension of time now, while the standards are being developed, than to wait for it to near finish line.

Kind regards

Confederation of Swedish Enterprise

The Council for Swedish Financial Reporting Supervision

FAR (The Institute for the Accountancy Profession in Sweden)

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[5] To allow financial market participants to comply with the Sustainable Finance Disclosure Regulation (2019/2088), a practical solution would be to start with a smaller reporting package, one which reflects the mandatory principal adverse impacts set out by the related Delegated Act of that Regulation ahead of the full ESRS. The SFDR requirements thus do not have to become an obstacle for allowing EFRAG to develop high quality standards based on a thorough impact assessment and the forthcoming work of the ISSB.