5 August 2022

Saskia Slomp
EFRAG
35 Square de Meeûs
1000 Brussels (fifth floor)
Belgium

Dear Saskia,

DRAFT EUROPEAN SUSTAINABILITY REPORTING STANDARDS

ICAEW welcomes the opportunity to respond to EFRAG's draft European Sustainability Reporting Standards. ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of sustainable economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 161,000 chartered accountant members in over 147 countries.

Summary

We strongly support the ambitions of the European Green Deal and the provisions set out in the proposed Corporate Sustainability Reporting Directive (CSRD) to mandate the reporting and assurance of corporate sustainability information in Europe. We recognise and commend the considerable time invested by members of the Project Task Force (PTF-ESRS) in developing a set of proposed European Sustainability Reporting Standards (ESRSs) covering a broad range of sustainability matters in a very short timeframe.

We have serious concerns, however, that the draft standards in their current form do not meet fully the objectives of the CSRD. As explained below, we believe that the proposals would create complexity due to their granularity and volume, and contribute to a fragmented international sustainability reporting system. This would not be in the interests of stakeholders, including users, preparers, assurance providers and regulators. We strongly recommend that EFRAG reconsiders how best to align its standards with those of the International Sustainability Standards Board

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(ISSB) on a global baseline for sustainability reporting and explicitly identifies where supplementary disclosures are required on public policy grounds to meet the objectives of the CSRD.

Introduction

The urgent need to develop a global framework for the reporting of climate-related and other sustainability matters, and the infrastructure required for its effective implementation, is a major focus of ICAEW's wide-ranging programme of work in support of the Paris Agreement and the United Nation's Sustainable Development Goals. We are longstanding supporters of widely applied, high quality international reporting standards and believe that global alignment is critical to efforts to meet the increasing demand from investors and other users of company reports for consistent, comparable and reliable information on sustainability matters.

With over 6,500 members located in the EEA, ICAEW members will be directly impacted by the proposals. Additionally, the CSRD will extend requirements to non-EU companies that are listed on an EU regulated market or that have a net turnover of more than €150m in the EU and at least one subsidiary or branch in the EU (subject to certain thresholds).

To assist in our assessment of global and jurisdictional proposals for new requirements for the reporting of sustainability matters in mainstream financial filings, we make reference to a number of broad, inter-related principles, as follows:

1. Due process is transparent and of sufficient quality; the proposals were preceded by effective outreach, are clear and accessible, and constituents have sufficient opportunity to provide effective input.
2. The proposals are likely to enhance significantly, the availability to investors of high quality and consistent information on sustainability matters.
3. The new or enhanced information will be published at the same time as the financial statements, to encourage connectivity and investor understanding.
4. Implementation dates have due regard to the degree of preparedness of reporting entities within scope and the practical challenges of implementation.
5. The new or enhanced information proposed is capable of being subjected to a third-party assurance regime to enhance investor confidence in the reliability of the reported information.
6. The proposals contribute to the global alignment of sustainability reporting requirements, including definitions and language, to minimise in particular the challenges of compliance for reporting entities subject to more than one regulatory regime.

It is in this context that we have undertaken a high-level review of EFRAG's main proposals, focusing on ESRS 1 *General principles* and ESRS 2 *General, strategy, governance and materiality assessment*. Although we have not addressed all of EFRAG's detailed survey questions, our silence on matters outside the scope of our high-level review should not be interpreted as support.

In commenting on these draft standards, we draw on our experience of similar reporting innovations while acknowledging EFRAG's particular role as a standard-setter and technical advisor to the European Commission in the sustainability reporting field. We also acknowledge that in drafting the proposed ESRSs, EFRAG operates under the parameters of the legal framework set out by the CSRD.

An International Outlook

The proliferation of climate and other sustainability reporting frameworks around the world has been a major obstacle to efforts to improve the ability of investors to understand and compare reported information in this area. It is therefore imperative that the EU works towards greater interoperability between the ESRSs and the global baseline being developed by the International Sustainability Standards Board (ISSB), an objective supported by Recital 37 of the CSRD proposal:

To avoid unnecessary regulatory fragmentation that may have negative consequences for undertakings operating globally, European standards should contribute to the process of convergence of sustainability reporting standards at a global level, by supporting the work of the International Sustainability Standards Board (ISSB). European standards should reduce the risk of inconsistent reporting requirements on undertakings that operate globally by integrating the content of global baseline standards to be developed by the ISSB, to the extent that the content of the ISSB baseline standards is consistent with the EU's legal framework and the objectives of the European Green Deal.

We do not believe that the proposals in their current form meet this objective and suggest that fundamental changes to the draft ESRSs are required to do so. If a high degree of consistency is not achieved, compliance for entities will be unduly complex, costly and result in unnecessarily lengthy reports of questionable value to stakeholders and investors. We question whether there is any benefit in EFRAG departing from the ISSB's work to establish a global baseline, except where required by the CSRD.

Architecture and structure

In order to achieve greater consistency between the European and international frameworks, we call for further consideration of the architecture and structure of the draft standards (*question posed in **Survey 1A, Q3***). We strongly suggest that ESRS requirements which are over and above the ISSB's global baseline are explicitly identified within the standards. This would enable preparers, assurers, users and regulators to better understand and identify differences from the proposed ISSB Standards.

Closer alignment with the ISSB's framework is important for both the understandability of sustainability reporting and to the entities that will fall within the scope of both sets of sustainability reporting standards. To meet the needs of wider stakeholder groups beyond investors, we also encourage greater convergence with GRI Standards - a framework aiming to achieve global best practice for impact reporting.

A more consistent architecture and structure would maximise the benefits of EFRAG's collaboration with the ISSB and GRI and reduce the current complexity of the draft ESRSs. Importantly, it would also minimise the reporting burden on European and other entities that might be required to report under both frameworks. Such entities would otherwise unreasonably be expected to determine which ESRS reporting requirements have already been met through compliance with the ISSB or GRI requirements.

Terminology and key definitions
In light of our comments above, it is important for all relevant bodies to prioritise global agreement of fundamental definitions and terms. Agreement between EFRAG and the ISSB on the definitions of shared concepts relating to sustainability-related information is critical in improving the understandability of the ESRSs. For example, aligning the concept of value chain reporting would help with identified challenges in defining reporting boundaries. Greater alignment between the terminology could also improve understanding of terms such as 'sustainability-related', 'significant' and 'material' as well as the characteristics of information quality (*question posed in* ***Survey 1C, Q38****).* The inclusion of a glossary as an appendix to ESRS 1 to provide greater clarity of concepts and terminology would also be a welcome addition.

Key concepts - materiality
The current proposals relating to the double materiality concept lack clarity and would be complex to implement (*question posed in* ***Survey 1B, Q19***). We strongly suggest that EFRAG aligns its definition of 'financial materiality' to that proposed by the ISSB. This would be a significant step towards greater convergence of sustainability reporting standards; a clear objective of the CSRD.

We agree that materiality should reflect how sustainability matters affect an entity and its enterprise value as well as how the entity impacts the environment and society, to the extent that it affects enterprise value. However, the proposals do not provide a clearly defined basis to assess 'impact materiality' where it does not affect enterprise value.

We encourage EFRAG to clarify expectations on this matter by issuing additional guidance in a similar vein to the IFRS Practice Statement *Making Materiality Judgements*. Illustrative examples and expected best practice are necessary to achieve consistency and comparability in reporting.

We do not support the inclusion of the 'rebuttable presumption' concept due to the challenges it would present to both preparers and assurers in gathering and assuring 'reasonable and supportable evidence' (*question posed in* ***Survey 1B, Q24***). The concept will be complex and costly for entities to apply and in some circumstances, gathering sufficient evidence to support rebutting the presumption will simply not be possible. A practical inability to rebut the materiality presumption is likely to lead to a 'tick box approach' to requirements, resulting in a high prevalence of 'boilerplate' disclosures. Furthermore, we believe that greater clarity on making materiality judgements through additional guidance (as outlined above) could remove the need for the rebuttable presumption concept.

Company preparedness

The challenges that companies will face in implementing sustainability-related disclosure requirements, in Europe and elsewhere, are not to be underestimated. These may extend to new governance arrangements, systems implementation, revised data collection requirements and improvements to internal controls. Expertise and capacity will be in short supply throughout the corporate reporting eco-system. This may in turn impact the ability of investors and other stakeholders to make use of the disclosures.

The disclosure requirements under the draft ESRSs are significant in volume and are structured within a complex architecture. The level of prescription and granularity within these proposed standards risk the creation of a compliance driven exercise that could result in low quality disclosures. These challenges are only further increased where an entity operates under multiple reporting regimes and is therefore required to navigate more than one reporting framework. With this in mind, we call for simplification of the requirements where possible, including making application guidance non-mandatory, and also believe there is a need for significant phasing-in of the disclosure requirements.

While the provisional CSRD does provide some scope for phasing-in (with regard to value chain reporting), we suggest further phasing to acknowledge that reporting under new sustainability disclosure frameworks will be a journey, with entities moving towards full compliance over time. We would support phasing that prioritises critical, sector-agnostic disclosures initially, with additional and sector-specific disclosures at a later point in time (*question posed in* ***Survey 2, Q56***).

Appropriate phasing-in, however, will only be successful once the above concerns over structure, key concepts and terminology have been addressed.

Auditability

The aforementioned concerns regarding the lack of clarity and alignment of key concepts and terminology present serious challenges for assurance providers. We question whether the proposed standards are in fact verifiable in their current condition due to the lack of clarity over the key concepts including double materiality, the challenges involved in defining reporting boundaries, and the quality and quantity of evidence likely to be available to auditors to support the disclosure of highly uncertain estimates. We believe further work and drafting is needed before the proposals can provide a suitable basis for auditors and regulators to determine whether an entity has complied with them.

The importance of due process

We are aware of the ambitious deadline to submit the first set of draft ESRSs to the European Commission by November 2022 and do not believe that this allows sufficient time for robust due process. While we agree that there is an urgent need for sustainability reporting standards, it is also essential that they are of high quality and, as a newly appointed EU-wide standard setter, set a standard of quality that can be expected of EFRAG in the future. The proposed disclosure requirements and application guidelines are significant in volume and require a high level of scrutiny to ensure that the final standards are accessible by both preparers and users and meet the objectives of the CSRD.

Robust due process procedures and strong governance are essential to ensure that the serious concerns outlined above on the drafting of these standards are addressed sufficiently. The impact of quality issues in sustainability reporting could have wide reaching consequences, potentially impacting European companies' access to the global capital needed to meet the ambitions of the European Green Deal. It is therefore essential that all feedback, including any general comments submitted separately from the survey, are properly analysed and considered by those responsible for the draft standards.

We consider that the pace at which ESRSs are being developed will undermine their ability to result in high-quality, understandable disclosures that will benefit investors and other stakeholders.

We therefore respectfully ask EFRAG to take adequate time to address all of the comments received and improve the proposals as necessary.

Conclusion

In summary, we have some strong reservations about the proposed European sustainability standards, which do not clearly demonstrate alignment to the global baseline being developed by the ISSB. We believe that the draft standards fall short of the six principles set out earlier in this letter and encourage EFRAG to reconsider how it can more successfully build on existing and proposed global frameworks. We also strongly suggest sufficient time be given to the development of a high-calibre suite of ESRSs and emphasise the importance of quality over speed to achieve the goal of increased corporate transparency and relevant, consistent and comparable sustainability reporting.

Please do not hesitate to contact me if you require any further information.

Yours sincerely

Nigel Sleigh-Johnson

Dr Nigel Sleigh-Johnson
Director, Audit & Corporate Reporting, ICAEW