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Our ref **CZ_ESRS CL**

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Dear Members of the European Sustainability Reporting Board

Exposure Drafts of European Sustainability Reporting Standards

We appreciate the opportunity to comment on the Draft European Sustainability Reporting Standards (ESRSs) issued by the EFRAG Sustainability Reporting Board (EFRAG) for public consultation. We have consulted with our member firms to ensure this letter best represents the views of the KPMG global organisation.

We acknowledge the significant achievement of EFRAG and its Project Task Force (PTF) in delivering the ESRS exposure drafts under an ambitious timeline with the Corporate Sustainability Reporting Directive (CSRD) in proposal status.

We recognise the urgent need for sustainability information, transparency, and comparability to support the European Green Deal and meet the ambitious targets the European Union has set. This requires high quality standard-setting to help preparers achieve more consistent and comparable disclosures, while at the same time seeking to avoid “greenwashing”. Standard-setting will support stakeholders as they seek more in-depth and better quality information about sustainability-related impacts, risks and opportunities. We therefore support the initiative taken by the European Union to create a comprehensive set of rules to inform stakeholders on sustainability matters in its decision making.

In the meantime, the European legislative bodies have agreed on the CSRD and included – among other amendments – a statement that requires the European Commission to take account of the work of global standard-setting initiatives for sustainability reporting “to the greatest extent possible” when adopting delegated acts (Article 1.7b of the CSRD, amending the Accounting Directive with Article 29b.3). We acknowledge that this requirement is not yet fully reflected in the exposure drafts and we therefore make suggestions on how this could be addressed.

We are responding to the exposure drafts based on our deep global experience in the following fields: financial reporting and the audit of financial statements, including internal control over financial reporting; climate strategy and decarbonisation; and sustainability (and Environmental, Social and Governance, or ESG) reporting.

We have been providing assurance over sustainability information for over two decades. During this time, we have been actively engaged with organisations in the largely voluntary landscape of sustainability standard-setting, including with the Global Reporting Initiative (GRI), as well as the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (VRF) ahead of their consolidation into the IFRS Foundation. Our global organisation is organised and coordinated across all of our business, and provides us with a broad perspective on the opportunities and challenges associated with the preparation, reporting and assurance of sustainability information.

Our experience and perspective have informed our assessment of the exposure drafts, including the observations and recommendations we make in this letter. This cover letter outlines our key observations and substantive recommendations, supported by the more detailed responses in the online questionnaire.

Interaction with ISSB

We support an approach that would allow national and regional jurisdictions to build on a global baseline and set supplemental standards that serve their specific jurisdictional needs – a ‘building blocks approach’. This practical approach would support international consistency and efficiency savings for companies operating in international markets, reducing the cost and complexity of compliance with multiple sustainability reporting frameworks.

In November 2021, the IFRS[®] Foundation announced the formation of the International Sustainability Standards Board (ISSB[™] Board) with the vision of creating that global baseline. The IFRS Foundation has had the advantage of being able to build on existing expertise, including that of the Task Force on Climate-related Financial Disclosures (TCFD) and the VRF. It has considerable institutional support – from the G7, G20, International Organization of Securities Commissions (IOSCO) and the Financial Stability Board (FSB) – as well as from companies and investors around the world.

Our vision for the future is a global reporting ecosystem for sustainability-related information that combines a focus on enterprise value to meet the needs of capital market participants with reporting on impacts that serves the needs of a broader group of stakeholders. In our view, these aims are complementary. Given the mandate of the IFRS Foundation, the ISSB Board’s focus is on enterprise value only.

We acknowledge the commitments made by the ISSB and the GRI to coordinate their work programmes and standard-setting activities, recognising the importance of connectivity and the need for a global, interconnected system for sustainability

reporting designed to meet the needs of the capital markets and that for a broader group of stakeholders.

Therefore, we would recommend that EFRAG continues to build on GRI standards for its impact reporting and cooperates with the ISSB in the development of future enterprise value focused standards. Where European needs differ, e.g. because of existing EU legislation or more ambitious policy imperatives, EFRAG can add or adapt disclosure requirements to meet those needs.

We are therefore encouraged by the collaborative message coming from the May 2022 meeting of the ISSB Board's Jurisdictional Working Group and the recognition that a key focus is to understand differences between current proposals and the resulting impact on stakeholders¹. We welcome the clarification provided by the CSRD agreed by the trilogue negotiations to require taking account of international developments.

With this in mind, we recommend EFRAG and the ISSB Board work together to align the principles, structure, concepts, terminology and measurement bases that underpin the disclosures. This would enable EFRAG to focus on those additional requirements necessary to meet the more extensive scope of the CSRD.

For example:

- Principles: ESRG 1 and ESRS 1 contain a definition of financial materiality in sustainability reporting that is narrower than the materiality concept used in proposed IFRS Sustainability Disclosure Standards as it excludes those matters that are captured by the financial materiality in the financial statements. These design differences are significant and if left unresolved will create complexities that impede the interoperability of IFRS Sustainability Disclosure Standards and ESRSs.
- Structure: The TCFD structure is widely used and was previously recommended by the NFRD as a reference framework. However, unlike the ISSB, EFRAG have adopted an alternative reporting structure to this developing consensus. Without doubting the equivalent merits of EFRAG's proposed structure, we think that adopting a different reporting structure will create unnecessary complexity for preparers. There still remains a short window of opportunity to address this misalignment.
- Concepts: The characteristics of information quality are similar (but not identical) to the characteristics in IFRS Sustainability Disclosure Standards, leading to differences in a company's assessment of what and how to report.

The recognition of IFRS Sustainability Disclosure Standards as a global baseline creates a complexity with regards to the timing of preparing topical standards. This is because EFRAG has already exposed proposals for all ESG topics while the ISSB Board has prioritised climate. To arrive at consistent frameworks, this complexity could

¹ [Public summary of the International Sustainability Standards Board Jurisdictional Working Group Meeting held on 16 May 2022](https://www.ifrs.org/content/dam/ifrs/meetings/2022/may/jwg/jwg-meeting-summary-may-2022.pdf). IFRS Foundation, 16 May 2022, <https://www.ifrs.org/content/dam/ifrs/meetings/2022/may/jwg/jwg-meeting-summary-may-2022.pdf>. Retrieved 29 July 2022.

be addressed either by cooperation between EFRAG and the ISSB Board when developing further topical standards or by developing a process that allows for gradually replacing requirements in the ESRs as comparable IFRS Sustainability Disclosure Standards become effective.

As a priority, EFRAG and the ISSB Board should work together to align the structure, definitions and reporting principles from the outset by way of coordinating and using aligned wording in the two sets of standards as well as in future sector-specific standards.

The need for globally consistent frameworks is further underlined by practical implications as a consequence of differences in frameworks. Multinationals and/or their components could also be subject to reporting responsibilities in other jurisdictions. Differences in standards will require multiple systems, processes and other factors that exponentially increase the burden on preparers and ultimately do not progress towards the goal of adequate, transparent and comparable sustainability reporting.

Balancing costs and benefits

Without pre-empting the feedback provided by preparers or users or the results of the economic study required by EFRAG due process, we note that the disclosure requirements (DRs) are extensive. Recognising the urgent need for sustainability information by a wide range of stakeholders, we are also conscious of the difficulties some of the required disclosures will pose for preparers. We therefore appreciate the possibility for preparers to provide comments on the cost-benefit balance as part of the detailed response survey.

Overall, we are concerned with the high volume of required disclosures and the vast amount of data points that companies will have to collect and report on. The scale of DRs becomes even more extensive as information has to be evaluated against two materiality perspectives, as well as covering not only the company itself but also its upstream and downstream value chain. Some DRs have to be reported across multiple dimensions, for example DR 1 in ESRs S1 on own workforce requires a summary of policies or commitments of a company on 19 different aspects broken down by groups of employees. This multitude of reporting aspects acts as a multiplier on volume.

Reporting under the ESRs will take focus away from those few performance measures that are most important to a company and its stakeholders by requiring a data book approach that is very different to the discussion and analysis currently provided in management reports produced under the Accounting Directive. This approach bears the risk that reporting becomes a mere compliance exercise instead of allowing management to focus its attention to improve those KPIs that matter most from an enterprise value and impact perspective. While such extensive data provision might support detailed data analysis, it does not help to facilitate the highest quality information or to get an understanding of the company's most relevant sustainability-related impacts, risks, and opportunities and management's response to those.

Rebuttable presumption

An entity-specific level of materiality assessment is provided in the form of the rebuttable presumption which allows companies to reduce the reporting where topics are not material. However, in practice a company would likely find it difficult to rebut the presumption of materiality to justify the exclusion of information specified by individual disclosure requirements. The rebuttal could easily be vulnerable to challenges from regulators, assurance service providers and stakeholders on the grounds of the importance of the matter to any individual stakeholder, requiring a significant documentation effort. Companies might avoid such effort by deciding not to use the option to rebut and report on all standards by default.

We therefore recommend removing the rebuttable presumption (documentation of why information has not been included) and instead only require the application of those topical standards that lead to information that is material to stakeholders (documentation of why information is included). Sector-specific standards could state whether specific topics are likely to be material for each sector.

Prioritisation and phase-in

We acknowledge the importance in assessing the feasibility in implementing disclosure requirements. However, equally important is the relevance of a disclosure requirement for a stakeholder. Therefore, we believe EFRAG should carefully consider the relevance of the proposed DRs from the perspective of the stakeholders.

To balance the urgent need for information by stakeholders and the burden the requirements put on companies, we suggest differentiating by standard as well as individual DRs. One practical way to approach this is to allow companies to assess the materiality of each ESG topic and sub-topic and only apply those (sub-) topical standards that are considered to deliver most relevant information to stakeholders (i.e. not apply the rebuttable presumption in the first years of application).

Similar to the approach taken by GRI, EFRAG could in each standard identify and require only those core DRs that are most important to stakeholders from an impact perspective (or because they are explicitly required by the CSRD). Other DRs would be applied based on the entity-specific materiality assessment or voluntarily. Where a sector has significant impact on environment or people, sector-specific standards could introduce additional (otherwise voluntary) DRs as core DRs, effectively making them mandatory for that sector.

Of all the topical standards, E1 seems to be the most mature in terms of availability of data and application guidance including literature. It is also the standard that delivers most important information for the largest group of stakeholders. This standard should form part of the initial set of standards to be applied mandatorily.

We provide ratings on prioritisation in our response to the online survey.

ESRS as a reporting framework

EFRAG has publicly confirmed that ESRS are not intended to dictate particular corporate action. However, ESRSs in some places do seem to require a particular course of action. A clear example can be found in ESRS 2 Paragraph 70 where corporate action is required in response to material sustainability impacts, risks and opportunities identified.

We would suggest clarifying that the requirement addresses reporting only.

Digital reporting requirements

The draft ESRSs present multiple options to report on the sustainability matters in the management board report, including options to refer to other sections. The CSRD requires electronic formatting to be used for sustainability reporting, which currently does not seem to have been considered as part of the exposure drafts or in how the options to present sustainability information have been given. Due to complexities of (block) tagging at higher or more detailed levels, we recommend EFRAG to consider potential complexities resulting from electronic reporting requirements and ensure that related taxonomies will adequately facilitate electronic reporting of sustainability matters.

We suggest EFRAG and the ISSB Board work closely together to develop a common taxonomy.

Application of ESRSs to financial sector companies

There is currently a lack of guidance on how to apply the ESRSs to financial sector companies like banks, asset managers or insurance companies. For example, there is no guidance on whether or how to apply the concept of the boundary of the value chain to activities financed by financial products.

The EU Taxonomy (Regulation (EU) 2020/852) requires financial sector companies to look through to the activities financed by collecting taxonomy data from companies they invested in. However, the taxonomy only requires data on three different KPIs. If financed activities would have to be considered under ESRSs, this would require financial sector companies to collect a significant amount of data from thousands of companies.

While it would seem sensible to require financial sector companies to look through at the activities financed, it seems impracticable to implement without further guidance that address the specifics of value chains in the financial sector.

In addition to our suggestion to align general principles with international standards, we would suggest for financial institutions also to aim for alignment with existing regulatory

requirements (esp. EBA Pillar III, Solvency II, CRR related obligations under the EU Taxonomy). This would help to ensure data consistency between different reporting frameworks, to enhance data quality and to contribute to a single set of meaningful information to different stakeholders by reducing information gaps for comparable issues.

The application of the materiality concept as currently defined leads to an open-ended reporting requirement by financial sector companies. If banks, asset managers or insurance companies were to consider all the activities financed, they would have to report sector-specific information on almost all sectors in which they have invested.

As a result, financial sector companies will almost never be able to demonstrate that a topic is not material given the diversity of financial product portfolios.

Considerations on assurability (reasonable assurance)

We support the ambition of the CSRD to require limited assurance over sustainability reports from the outset with the intent to move to reasonable assurance over time to make sustainability disclosures as robust and reliable for users as financial information. Assurance over sustainability DRs is significantly more complex than assurance over financial reporting due to the larger boundary of reporting, including the value chain both upstream and downstream, and the impact materiality layer that requires consideration of matters that are outside of a company's internal processes. Furthermore, EFRAG should carefully consider the implications of requiring disclosure of the controls implemented. This is different compared to IFRS, where currently there is no such requirement. It is as of yet unclear whether assurance will be required over the effectiveness of those controls. In the EU, there is limited experience with reporting on and providing assurance over controls over financial reporting, such as for example entities have subject to SEC reporting requirements. The proposed DRs on controls may be challenging to implement for reporting entities and result in additional complexities if also in scope of the limited assurance requirement.

The increased difficulty requires assurance standards that clearly set out the expectations that an assurance service provider would need to meet.

As EFRAG considers assurability when developing the ESRs and engages with stakeholders on this topic, we believe it is critical that there is a shared understanding of what the conclusion of an assurance service provider would be able to cover. As ESRs set requirements for what information should be disclosed by the reporting company but do not set criteria with respect to how such information should be recognized and measured, the conclusion can only address whether disclosures are complete, but could not address recognition and measurement. Since the quality of assurance is dependent, amongst others, on the clarity of the reporting framework, we highly recommend EFRAG to build the appropriate structures within its governance for implementation support in order to be able to give timely guidance to resolve areas where divergent views may arise in practice.

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At the moment, the International Auditing and Assurance Standards Board (IAASB) is working on a project to develop new or enhance existing standards to be applied to sustainability reports.

Pending these developments, we comment on the assurability of DRs based on existent assurance standards (e.g. ISAE 3000). Generally, if a company is able to collect the data to meet the DRs, this process can also provide evidence for an assurance service provider to conclude on whether the DRs have been met. However, there might be a significant additional cost to that assurance given that data might come from outside the company's control due to the expansion of the scope to the boundaries of the value chain, not be sufficiently evidenced by audit trails, be insufficiently accessible in absence of audit rights, etc. To address this, companies would have to implement contractual access and auditing rights along the supply chain or set up certification procedures similar to those performed on internal controls over financial reporting under ISAE 3402.

An assurance conclusion suggests that the assurance service provider has obtained sufficient appropriate evidence to conclude that the risk of material non-compliance with DRs is reduced to an acceptably low level. However, the way that impact materiality is currently defined creates an open-ended obligation to report on any information that is of interest to any stakeholder. Ensuring compliance with DRs based on this definition and obtaining assurance over it will require significant effort both for the preparer in order to collect the information and the assurance service provider to obtain sufficient and appropriate evidence that the DRs have been met. We therefore welcome the amendment to the CSRD text that makes any reasonable assurance requirement subject to a feasibility assessment and the development of assurance standards which governs the scope of work required by an assurance service provider.

We provide our detailed responses to the individual survey questions using the online form.

Please contact Christian Zeitler (czeitler@kpmg.de) or Ramon Jubels (jubels.ramon@kpmg.nl) if you wish to discuss any of the issues raised in this letter.

Yours sincerely



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