ESRS: Reporting at consolidated level – new text of the CSRD (Subsidiary exemption)

Objective

1 The objective of this paper is to consider the changes to ESRS 1 that are needed in order to incorporate the changes to the final CSRD when reporting at consolidated level.

Background

2 Similar to financial reporting, sustainability statements can be on a consolidated basis. The CSRD grants the subsidiary exemption for those subsidiaries that are included in the consolidated sustainability reporting of a controlling entity. The controlling entity is referred to as *parent company*.

3 In accounting, consolidation is the elimination of inter-company relationships to present the parent company and its subsidiaries in the financial statements as if they were one entity. So, consider two identical undertakings, except one being organised in only one legal entity, and the other being organized in a group structure that involves many subsidiaries (separate legal entities). After consolidation, the financial statements of the latter (organized in a group) will be identical to the former.

4 CSRD Art 29a para 3a provides for (for recitals and full text see Appendix I):

> *"Where the reporting undertaking identifies* ***significant differences*** *between the risks or impacts of the group and the risks or impacts of one or more its subsidiaries, the undertaking shall provide an adequate understanding of the risks and impacts, as appropriate, of the subsidiary or subsidiaries concerned."*

5 In an SR TEG meeting on 20 June it was agreed that some guidance on qualitative aspects/triggers should be developed and if possible, some illustrative examples for the November 2022 deadline.

Current principle in ED ESRS 1

6 ED ESRS 1 para 128 - 129 in chapter 4.9 "Consolidated reporting and subsidiary exemption" are as follows:

> 128 "When the undertaking is reporting at a consolidated level and one or more of its subsidiaries is using the subsidiary exemption of the CSRD the undertaking shall perform its assessment of material impacts, risks and opportunities for the entire consolidated group, regardless of its group legal structure, making sure that all subsidiaries are covered in a way that allows for the unbiased identification of material impacts, risks and opportunities.
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> 129 Criteria and thresholds for assessing an impact, risk or opportunity as material shall be determined based on chapter **Error! Reference source not found.**."

Proposal for re-drafting

7 When drafting para 128 of ESRS 1 the PTF considered that the assessment of impacts, risks or opportunities of a group is consolidation (i.e. in the sense of bringing together / "combination of a number of things") of all impacts, risks or opportunities based on the materiality principle, no matter where in the group structure they arise.

8 The EFRAG secretariat acknowledges that the restriction "and one or more of its subsidiaries is using the subsidiary exemption" is not a necessary precondition when the principles for "sustainability reporting at a consolidated level" should apply and therefore should be deleted.

9 To consider the new text of the CSRD the EFRAG secretariat proposes the following redrafting of paragraph 128 of ESRS 1:

When the undertaking is reporting at a consolidated level ~~and one or more of its subsidiaries is using the subsidiary exemption of the CSRD~~ the undertaking shall perform its assessment of material impacts, risks and opportunities for the entire consolidated group, regardless of its group legal structure, making sure that all subsidiaries are covered in a way that allows for the unbiased identification of material impacts, risks and opportunities. It is necessary that parent undertakings reporting at consolidated level provide an adequate understanding of the risks and impacts of their subsidiaries, including information on their due diligence processes where appropriate.

There might be cases where the differences between the situation of the group and its individual subsidiaries, or between the situation of individual subsidiaries in different geographies are significant and would, in the absence of additional information about the individual subsidiary concerned, cause the user to reach a substantially different conclusion about the risks or impacts of the subsidiary.

Where the undertaking identifies significant differences between the risks or impacts of the group and the risks or impacts of one or more of its subsidiaries, the undertaking shall provide an adequate understanding of the risks and impacts, as appropriate, of the subsidiary or subsidiaries concerned.

The following two examples illustrate circumstances where the undertaking would identify significant differences between the risks or impacts of the group and the risks or impacts of a subsidiary:

a) A group that is manufacturing cars or chemical products has a coal power plant in a separate subsidiary to produce energy exclusively for its production facilities. The impacts on people and the environment of producing energy in a coal-power plant, as well as the risks connected to it, are significantly different from car or chemical production and should be reported.

b) A bank provides finance to a newco to finance the construction of a windfarm in the Ocean. Due to technical issues, the revenues generated by the windfarm are not sufficient to repay the loan to the bank. The bank acquires the ownership of the windfarm in order to recover his loan and has to operate the windfarm in order to collect the cash flows. The impacts on people and the environment of operating a windfarm in the Ocean, as well as the risks connected to it, are significantly different from banking operations and should be reported.

Listing of subsidiaries using the consolidation exemption

10 The CSRD requires:

> "Undertakings shall indicate which subsidiaries included in the consolidation are exempted from individual or consolidated reporting according to Articles 19a(7) or 29a(7) respectively."

11 This new requirement has not been considered in the ED ESRS. It is best placed in the general disclosure requirements of ESRS 2. It is worthwhile to note that Article 28 (2) (a) of the Accounting Directive requires a listing "in relation to undertakings included in consolidation". As currently drafted (see ESRS 2 paragraph 2) "incorporation by reference" is allowed for the general disclosure requirements of ESRS 2. So, the list of undertakings included in consolidated financial statements and the list of exempted subsidiaries under the CSRD can be combined.

12 The following amendment is proposed to ESRS 2 paragraph 5 (new text in red):

"The undertaking shall disclose the key features of its sustainability report:

(a) whether the sustainability report is consolidated or individual;

(b) in the case of a consolidated sustainability report

  (i) a confirmation that the reporting scope (see ESRS 1) used for sustainability reporting is identical to the scope used for the consolidated financial statements;

  (ii) a list of subsidiaries being exempted from individual or consolidated reporting according to Articles 19a(7) or 29a(7) of the CSRD respectively;

(c) for an undertaking based in an EU member state that allows for the exemption in articles 19a (3) and 29a (3) of the CSRD on disclosure of information prejudicial to its commercial position, the use of the option, if applicable; and

(d) where applicable the identification of the auditor, the audit firm or the independent assurance service provider giving assurance on the (consolidated) sustainability report and the level of assurance provided."

Questions for EFRAG SR TEG

13 Do EFRAG SR TEG members agree with the EFRAG Secretariat's proposal for

(a) re-drafting of paragraph 128?

(b) Listing of subsidiaries using the consolidation exemption?

14 If not, please explain.

Appendix 1: Excepts from the "new" CSRD

Recital 22:

(22) "Article 23 of Directive 2013/34/EU exempts parent undertakings from the obligation to prepare consolidated financial statements and a consolidated management report where those undertakings are subsidiaries of another parent undertaking that complies with that obligation. It should be specified, however, that the exemption regime for consolidated financial statements and consolidated management reports operates independently from the exemption regime for consolidated sustainability reporting. An undertaking can therefore be exempted from consolidated financial reporting obligations but not exempted from consolidated sustainability reporting obligations where its ultimate parent prepares consolidated financial statements and consolidated management reports in accordance with Union law, or in accordance with equivalent requirements if the undertaking is established in a third country, but does not prepare consolidated sustainability reporting in accordance with EU law, or in accordance with equivalent requirements if the undertaking is established in a third country. ***It is necessary that parent undertakings reporting at consolidated level provide an adequate understanding of the risks and impacts of their subsidiaries, including information on their due diligence processes where appropriate. There might be cases where the differences between the situation of the group and its individual subsidiaries, or between the situation of individual subsidiaries in different geographies are particularly significant and would, in the absence of additional information about the individual subsidiary concerned, <u>cause the user to reach a substantially different conclusion about the risks or impacts of the subsidiary.</u>*** *"*

Article 29a, para 3a.
"*Where the reporting undertaking identifies significant differences between the risks or impacts of the group and the risks or impacts of one or more its subsidiaries, the undertaking shall provide an adequate understanding of the risks and impacts, as appropriate, of the subsidiary or subsidiaries concerned.*
Undertakings shall indicate which subsidiaries included in the consolidation are exempted from individual or consolidated reporting according to Articles 19a(7) or 29a(7) respectively."