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Use test feedback Issues Paper²

Objective

- 1 The objective of this session is to discuss a summary of the feedback from the Use Test Focus Group.

Background

- 2 On 25 May 2022, EFRAG invited preparers to join its Use Test Focus Group to test the usability of the draft ESRS requirements through completion of a questionnaire and participating in a workshop. The questionnaire focussed on the operational and other challenges when reporting under the draft ESRS.
- 3 The questionnaire consisted of the following modules:
 - (a) General, strategy, governance and materiality assessment (ESRS 2);
 - (b) Climate change module (Covering ESRS E1);
 - (c) Other environmental matters module (Covering other E standards);
 - (d) Social module (Covering the S standards); and
 - (e) Governance module (Covering the G standards).
- 4 The application of ESRS 1 General principles formed part of the consideration of all the other modules. Preparers could select any module (or multiple ones) when answering the questionnaire and had until 30 June 2022 to submit their responses.
- 5 In the week of 13 July, nine workshops were held to discuss the results with another rescheduled for 20 July.

Respondents

- 6 In total, 33 preparers responded to the use test and have their headquarters in the following countries:

Country	Number of participants	Country	Number of participants
France	4	Poland	1
Germany	12	Spain	3
Italy	6	Sweden	1

¹ The EFRAG Secretariat would like to thank the participants for their efforts and diligence in completing the questionnaires as well as the open and clear discussions during the workshops. These were invaluable.

² This paper is the same paper as paper 03-02 presented at the 22 July 2022 EFRAG SR TEG meeting.

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Netherlands	3	United States	3
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- 7 Five of the respondents covered all modules and in total, preparers provided feedback on a total of 85 modules (an average of 2.6 modules per participant). The breakdown of the modules covered are as follows:

Module	Number of participants
ESRS 2: General, strategy, governance and materiality assessment	29
ESRS E1: Climate change	26
Other environmental matters (E2 to E5)	12
Social standards	11
Governance standards	7

- 8 25 of the respondents currently prepare NFRD information and from the information provided, six of those may have to do so in future. The remaining two may be eligible to provide information under the voluntary SME guidelines to be developed, but this was not confirmed.
- 9 The names, countries of headquarters as well as the sectors of the participants are set out in Appendix 1.

Questions for EFRAG SR TEG

- 10 Does EFRAG SR TEG have questions on the background information?

'Quantitative' feedback

Challenges per module

- 11 Participants were asked to select the type of implementation challenge module (they could select more than one response):

	ESRS 2	E1	E2-E5	Social	Gov
Unavailability of data	59%	81%	100%	77%	29%
Inadequate data quality	55%	77%	75%	62%	14%
Inadequate IT systems	34%	62%	75%	62%	14%
Excessive cost	55%	69%	75%	62%	14%
Lack of skills	24%	35%	33%	38%	-
Inadequate controls	24%	46%	58%	31%	29%
Timely completion of the statement	38%	31%	42%	23%	14%
Other	31%	19%	25%	23%	14%
The requirements can be implemented with a normal level of costs and efforts	14%	8%	-	8%	43%
The difficulties are expected to be lower with adequate implementation lead time	24%	12%	17%	-	-

- 12 Other challenges included:

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- (a) One undertaking described that they have 18 material topics per their published ESG strategic plan, but will have to extend the scope of their materiality assessment to cover also the DRs in ESRS;
 - (b) The lack of common methodologies for quantification of physical and transition risks specifically for ESRS E1. This is supplemented by a lack of clarity regarding the definition of material impacts. The following implementation questions on material impacts were mentioned:
 - (i) Is impact measured in terms of potential loss higher than x% in producibility due to change in climate variables?
 - (ii) To which scenario are we referring to?
 - (iii) Are all tools towards net zero considered the same, so that fossil fuels are rather to be eliminated than compensated?
 - (c) “In general, governance requirements can be found in several different standards. It is unclear which information is required at which point.”
- 13 The EFRAG Secretariat notes that the use test was completed before the changes to CSRD and the expected knock-on effects on standards such as ESRS 2 and ESRS G2 were known.
- 14 The information in the tables are provided in absolute terms of number of participants in Appendix 2.

Verifiability

- 15 Participants were asked about their views about the verifiability of the information required per module and the responses were as follows:

	ESRS 2	E1	E2-E5	Social	Gov
Fully	10%	12%	17%	8%	29%
Large extent/some reservations	41%	58%	17%	23%	29%
Limited extent/strong reservations	41%	23%	50%	62%	29%
No opinion	3%	8%	17%	8%	14%

- 16 The implications of the rebuttable presumption formed part of this debate as well as uncertainty as to how to prove that items/DRs etc. are not material, or the extent of the proof required. Also see paragraph 29 onwards below.

Reasonable cost/benefit balance

- 17 Participants were asked about their views about the cost/benefit balance of the information required per module and the responses were as follows:

	ESRS 2	E1	E2-E5	Social	Gov³
Fully	10%	4%	-	8%	-
Large extent/some reservations	31%	38%	17%	15%	-
Limited extent/strong reservations	38%	42%	58%	46%	14%

³ For the electronic survey there was a problem with this question, but even those that completed the Word document mostly did not complete this question.

Not at all	14%	12%	25%	31%	-
No opinion	3%	-	-	-	-

18 The granularity of disclosure requirements (without a clear benefit) was a concern here along with the rebuttable presumption.

Clarity of guidance

19 Participants were asked to select their views about the clarity of the guidance per module and the responses were as follows:

	ESRS 2	E1	E2-E5	Social	Gov
Fully	7%	12%	17%	8%	29%
Large extent/some reservations	28%	38%	8%	31%	14%
Limited extent/strong	48%	23%	42%	38%	14%
Not at all	7%	4%	17%	-	29%
No opinion	10%	23%	17%	23%	14%

Predominant themes

20 During the workshops, the EFRAG Secretariat touched on some of the important changes to the CSRD and how that may impact the draft ESRS EDs. Furthermore, the discussions were intended to understand the concerns and some of the comments provided. The discussions focussed on the following main aspects

Materiality

21 There was significant debate and discussion about how to operationalise the materiality assessment and the rebuttable presumption.

Further guidance

22 Preparers consistently requested further guidance on materiality assessment and there were several proposals for the addition of thresholds or criteria to ESRS 2.

23 The determination and evaluation of **impact materiality** also garnered significant discussion and preparers requested further guidance and illustrative examples. This included guidance as to when impact materiality for a small part of the own operations should be evaluated. One preparer referred to the Cluster working paper for the Guideline on 'Double materiality conceptual guidelines for standard setting' as useful and indicated that it should be included in ESRS 2.

“It will be challenging to audit the analysis as there are no guidelines, no precision on materiality...”

“... companies need to know how to document the process ... to meet the auditor's expectations...Therefore, include information on how to prepare for an audit...”

24 Participants were concerned that there may be differing interpretations of what would establish a 'link' to an undertaking's operations, products or services. For example, on climate:

- (a) at least one financial institution concluded that the environmental standards would not be relevant;
- (b) however, a technology company concluded that “most of the sustainability matters will be at some point material from either an impact or financial perspective”, given the diversity of their value chain which ranges from

industrial equipment to life sciences applications combined with the time horizon over which the assessment is made

- 25 Preparers also considered that there was insufficient guidance as to what would constitute **reasonable and sufficient evidence** for the conclusions about materiality (rebuttable presumption).
- 26 Other concerns included the level of granularity required to determine materiality as well as the stakeholders' involvement in the process as well as how the process should be documented.
- 27 A preparer proposed that such guidance do not necessarily need to be completed in time for November 2022 handover as long as it is available before application.
- 28 Examples included in ESRS E4 Biodiversity and ecosystems for sourcing of information was criticised: "... In our view, a reporting standard cannot be used to introduce as reference unofficial legislative acts; there should be at least generally recognised international guidelines like GHG protocol. Further, such documents are often of temporary nature, change with time or might be replaced with other regulations, which will require revision of the standards and restatements of information provided."

Rebuttable presumption

Participants were concerned that "the rebuttable presumption leads to disclosures of immaterial information"

and

"...an undertaking may have to include on its roadmap some targets that are not so material ..."

29 The majority of preparers thought that proving immateriality of a topic or subtopic may result in long discussions internally and/or with the auditors. To avoid this, some indicated that they would rather provide all required information. Others thought that given the different views on the determination of materiality that exist in the current standard setting debate, the rebuttable presumption was a good compromise. However, they did not support this kind of 'anti-avoidance' drafting. Preparers considered that there is a risk and potential for superfluous information to be provided as a result of the rebuttable presumption.

- 30 When confronted with the question on how many datapoints they think they would omit as a result of the use of the rebuttable presumption, most agreed that it is not possible to estimate the impact on omission of sub-topics or data points at this stage. Where estimates were provided, these varied from 0% to 50% with one undertaking indicating that they could only provide 40% of the required information for governance module. Another preparer indicated that less than 10% can be rebutted given the importance of all data points for the same module.

Value chain

- 31 There were several questions as to the extent the value chain needs to be considered and included.
- 32 The description of the reporting boundary in ESRS 1 paragraph 63 raises the question as to whether the policies, targets and actions etc. required in the topical standards need to be described also for the value chain. If this is not the intention, this should be clarified.

"The question of the breadth of the value chain arises. Up to what level do I have to report?"

IRO assessment

- 33 There was a proposal to follow the French transposition of the NFRD which requires an independent third party to review the impact and risk analysis process. Once this review has been carried out, the company is not required to describe the

methodology applied in detail; only the results must be published (i.e. a list of the main impacts/risks).

Incorporation by reference

- 34 The Secretariat has been considering how to allow the inclusion of references to the financial statements in an attempt to foster connectivity of financial and sustainability information.
- 35 During the session on the governance module, participants pointed out that current practice in Italy (as allowed by the Accounting Directive) is to issue a separate report on corporate governance rather than include the information in a section in the management report. These participants argued strongly that ESRS 2 paragraph 135 should be amended to allow references to such a report.
- 36 Others also argued that incorporation by reference will allow for some of the benefits of integrated reporting which is important as “[M]oving away from integrated reporting would be a major step backwards”.

Granularity and inflexibility

- 37 At the workshops, the granularity of requirements was often questioned. This included analysis of quantitative data (such as GHG emissions per country) and the implications of transport between countries or via international air/waters as well. Some also questioned the use and usefulness of such granular information. The usefulness of the disclosure requirement ESRS E1-10 *Total GHG emissions* was also questioned given the significant overlap and double counting this signifies.
- 38 Some preparers thought that given the level of granularity required, quantitative disclosure requirements should be phased in over two years whereas others considered that the most mature KPIs should be prioritised. These would include KPIs around climate change, pollution and water.
- 39 Some were concerned about references to all stakeholders in ESRS 2 rather than main categories of stakeholders which make the DRs inoperable.
- 40 Some mentioned another example of ‘anti-avoidance’; drafting ESRS 1 paragraph 98, which requires listing policies not disclosed (where the undertaking has no such policy). While this relates to material sustainability matters, given the concerns around materiality described above could result in a significant number of policies.
- 41 Preparers were also concerned about the wording, as it would imply inflexibility of the requirements, for example, the drafting of ESRS 2 SBM 3 paragraph 41(c)(i) presumes that the identification of a material impact would necessarily lead to a change in the undertaking’s strategy and business model. However, this may already have been taken into account and so no change is required to either strategy or the business model and only metrics may be required to manage the impact. This is repeated several times.

Participants were concerned that “ESRS 1 and 2 are too prescriptive on how to do things and require the description of too many irrelevant elements. Furthermore, these standards are not well suited to entities that are both global and multi-activity, giving rise to too much information”.

Next steps

- 42 Specific proposals to improve the drafting guidance has been shared with the EFRAG Secretariat members of the different standards for consideration. Many of the predominant themes have been discussed by SR TEG already and next steps agreed.

Questions for EFRAG SR TEG

- 43 Does EFRAG SR TEG have specific comments, suggestions or proposals on the feedback received?

Appendix 1: Participants to the use test

44 The following preparers participated in the use test.

Name	Headquarters	Industry/sector
Accor Investments	France	Hospitality
Amadeus	Spain	Technology
Audit professionals	Germany	Consulting
BMW	Germany	Automotive
Bosch	Germany	Engineering
Covea	France	Insurance
CSRinfo	Poland	Consulting
Dassault Systemes	France	Technology
Edeka-Suedwest	Germany	Food and beverages
Enbw	Germany	Utilities
Enel Group	Italy	Utilities
Eni	Italy	Oil&Gas/Energy
Eqtpartners	Sweden	Financial-Asset management
Evonik	Germany	Specialty Chemicals
Fundacion ONCE	Spain	NGO
Generali	Italy	Insurance
Heidelbergcement	Germany	Building materials
Heineken	Netherlands	Food and beverages
Hochland	Germany	Food and beverages
Inditex	Spain	Clothing
Intesa	Italy	Financial services
Leonardo	Italy	Aerospace & Defence
Net Zero Finance	United States	NGO
Omicell	United States	Healthcare technology
Pepsico	United States	Food and beverages

Name	Headquarters	Industry/sector
Poste Italiane	Italy	Postal, transportation, financial and insurance
Prosus	Netherlands	Technology - investor
Royal Philips NV	Netherlands	Healthcare
Siemens	Germany	Industrials
ThyssenKrupp	Germany	Industrial and technology
Veolia	France	Utilities
Voith	Germany	Technology
Wilo	Germany	Manufacturing

Appendix 2: Quantitative information in absolute terms

1 The tables below contain the same information as in the body of the paper, but in absolute terms, i.e., number of respondents.

Challenges per module

	ESRS 2	E1	E2-E5	Social	Gov
Unavailability of data	17	21	12	10	2
Inadequate data quality	16	20	9	8	1
Inadequate IT systems	10	16	9	8	1
Excessive cost	16	18	9	8	1
Lack of skills	7	9	4	5	-
Inadequate controls	7	12	7	4	2
Timely completion of the statement	11	8	5	3	1
Other	9	5	3	3	1
The requirements can be implemented with a normal level of costs and efforts	4	2	-	1	3
The difficulties are expected to be lower with adequate implementation lead time	7	3	2	-	-

Verifiability

	ESRS 2	E1	E2-E5	Social	Gov
Fully	3	3	2	1	2
Large extent/some reservations	12	15	2	3	2
Limited extent/strong reservations	12	6	6	8	2
No opinion	2	2	2	1	1

Reasonable cost/benefit balance

	ESRS 2	E1	E2-E5	Social	Gov ⁴
Fully	3	1	-	1	-
Large extent/some reservations	9	10	2	2	-
Limited extent/strong reservations	11	11	7	6	1
Not at all	4	3	3	4	-
No opinion	2	1	-	-	-

⁴ For the electronic survey there was a problem with this question, but even those that completed the Word document mostly did not complete this question.

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Clarity of guidance

	ESRS 2	E1	E2-E5	Social	Gov
Fully	2	3	2	1	2
Large extent/some reservations	8	10	1	4	1
Limited extent/strong	14	6	5	5	1
Not at all	2	1	2	-	2
No opinion	3	6	2	3	1