Towards a simplified ESRS Set 1: Preliminary suggestions from the staff of the four National Standard Setters (ANC, DRSC, ICAC, OIC)

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Disclaimer: This document is a working paper prepared by the staff of the French Standard Setter (ANC), the German Standard Setter (DRSC), the Spanish Standard Setter (ICAC) and the Italian Standard Setter (OIC) (4 NSSs) on the main general issues that should be addressed by EFRAG in the simplification phase of the ESRSs. The staff of the 4 NSSs have started a joint work to provide EFRAG with a proposal of simplification of the ESRSs in the context of the request that the European Commission sent to EFRAG. It is important to stress that simplification should not be approached solely through the lens of datapoint reduction; structural and conceptual streamlining of the Standards is at least equally important. Moreover, we recommend giving due consideration to the detailed proposals for the simplification of the Standards prepared by the French Standard Setter and shared with EFRAG. These proposals outline a direction of travel notably in respect to both the simplification levers put forward and overall volume of reporting requirements.

Double materiality assessment (DMA)

Feedbacks on the materiality assessment have shown that:

1. The evaluation processes were very cumbersome, notably due to the number of IROs evaluated and the need to document and justify criterion-by-criterion scoring to the auditors (often quantitative scoring when this was actually not required).
2. However, the results are not necessarily comparable, with different levels of granularity in the definition of IROs and different hierarchies even within the same sector.
3. A step back was even needed at the end of the process to readjust the results of the sustainability matters evaluation, which had been carried out mathematically by scoring the criteria and setting a materiality threshold to the detriment of common sense and strategic evidence.

As a reminder, IROs are the impact, risk or opportunity declinations of the sustainability matters, i.e. the topics or sub-topics or sub-sub-topics presented in AR 16: 27 environmental, 55 social and 7 on governance, i.e. a total of 89 sub-topics or sub-sub-topics which can be translated into several hundreds of IRO lines.

In this context, we propose to:

1. streamline the list of sustainability matters (AR 16) by limiting it to a list of sub-topics (21 environment, 14 social and 5 on governance, i.e. a total of 40) and deleting the notion of sub-sub-topics,

2. start the DMA by assessing the materiality of sub-topics (40 instead of 89 sub-sub-topics), so as to justify non-materiality only at sub-topic level, which would greatly help reduce the documentation effort,
3. require the undertaking to further assess material sub-topics at IRO level and report on the sub-topics considered as material in the form of impact, risk or opportunity (IRO).

This process therefore enables a top-down rather than bottom-up approach.
Finally, this approach should not modify the results of wave 1 undertakings, who do therefore not need to redo or change their materiality assessment. On the other hand, it would greatly simplify the DMA for wave 2 undertakings, and would also simplify updating the DMA for wave 1 undertakings should they choose to do so.

Value chain

The value chain is a vague concept, and it is difficult to apply in practice. The ESRS approach for the DMA requires an analysis of both the direct and indirect business partners in the upstream and downstream value chain in relation to material IROs (i.e. all tiers from Tier 1 to Tier N).

We suggest a simpler approach that allows undertaking to use generic information such as sectorial averages, sector analyses, peer benchmarks, life-cycle analysis or publicly available sources and – in addition – which is a risk-based approach for assessing such available information when performing its DMA.

Due to the difficulties for collecting primary data and ensuring their quality we suggest to modify ESRS 1 Section 5.2 "Estimation using sector averages and proxies" to no longer suggest that direct data collection in the value chain is the primary approach. §69 would be simplified like this: *~~There are circumstances~~ where the undertaking cannot directly collect the information about its upstream and downstream value chain as required by paragraph 63 ~~after making reasonable efforts to do so. In these circumstances,~~ the undertaking shall estimate the information to be reported about its upstream and downstream value chain, by using all reasonable and supportable information, such as sector-average data and other proxies.*

Moreover, with regards to metrics in the value chain, we expect that the collection of quantitative primary data along the value chain is, in principle, not required for the reporting of metrics, except for rare exceptions.

Anticipated Financial Effects

The concept of "potential" – later in the final ESRS Set 1 referred to as "anticipated" - financial effects was introduced in the draft ESRS to meet the CSRD requirement under Article 29b, which mandates disclosures on how sustainability matters affect the undertaking's development, performance, and position. These disclosures were also intended to align with international frameworks such as the TCFD and ISSB standards. During convergence discussions, EFRAG adopted the ISSB terminology "anticipated financial effects", defined in ESRS Annex 2 as financial effects not yet reflected in the financial statements.

Under IFRS S1, undertakings are required to disclose *quantitative* information on how sustainability-related risks and opportunities are expected to affect their financial position, performance, and cash flows over time. However, the standard allows for flexibility, including the use of ranges, the application of reasonable and supportable information, and exemptions where the effects are not separately identifiable or subject to significant uncertainty. In such cases, qualitative disclosure is required alongside an explanation of why quantitative data is not provided.

In their 2024 reports, many preparers used the phasing-in provisions to defer disclosure of anticipated financial effects. Based on preparing for this upcoming disclosure requirement they expressed serious

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concerns regarding the limited measurability and reliability of forward-looking information, the potential lack of reliability for users, and the sensitivity of commercially relevant data. Conversely, users - particularly investors - emphasized the importance of such information for their analyses.

In this context, NSSs call for a reassessment of the current requirements and a more proportionate approach to reporting anticipated financial effects. Specifically, it should be clarified whether such disclosures should include both narrative and quantitative information, narrative information only, or whether, in line with ISSB guidance, additional provisions should be introduced to allow the omission of quantitative data. These considerations are expected to be addressed through the EFRAG due process.

Sustainability reporting boundary and operational control concept

The introduction of "operational control" in the ESRS is one aspect that may lead to a divergence of the sustainability reporting scope from the financial reporting scope and which poses additional challenges for companies. As a general rule – unless otherwise specified – sustainability reporting scope should align with that of financial reporting (i.e., the parent undertaking and its fully consolidated subsidiaries).

We recommend allowing undertakings sufficient flexibility to reflect their business model through:

- allowing the option contained in the GHG Protocol (financial control or operational control), thereby ensuring interoperability with ISSB - and deleting the specific requirements on operational control for GHG emissions,
- allowing environmental datapoints other than GHG emissions to be reported based on the financial reporting perimeter, and/or on the operational control perimeter.

Eliminate redundant reporting requirements throughout ESRS (i.e., Grouping of Policies, Actions & Targets in topical ESRS, Simplification of ESRS 2 MDR-P, MDR-A, MDR-T, Removal of ESRS 2 topical requirements)

a) Interaction between ESRS 2 and the topical standards (GOV, SBM, IRO)

In the current version of the ESRS, the generic disclosure requirements set out in ESRS 2 in relation to governance (GOV), business model and strategy (SBM), and impacts, risks and opportunities (IRO) are repeated or further detailed in the topical standards in 20 instances, thereby generating redundancies in sustainability reporting. Most of these duplications can be removed, as the corresponding content falls within the scope of guidance.

Three cases, however, justify the retention of specific disclosure requirements within the topical standards:

- the transition plan for climate change mitigation,
- climate resilience analysis, and
- biodiversity-related resilience analysis.

b) Review of minimum disclosure requirements for policies, actions and targets

In order to focus sustainability statements on decision-useful information, MDR should be reduced to target the most critical aspects of policies, actions or targets.

Undertakings can also disclose MDR for PAT at sub-topic level, without the obligation to systematically translate them into IRO terms. Greater flexibility should be introduced regarding the scope covered and the placement of such information within the sustainability statement. Disclosures under the MDRs of ESRS 2 should be limited to substantial elements only.

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c) Streamlining PAT-related requirements in the topical standard

PAT-related disclosures should be made at the level at which they are managed and monitored, i.e. the disclosures depend on how these elements are structured and implemented within the undertaking. The ESRS should not mandate disclosures at a fixed topic or sub-topic level but rather allow undertakings to reflect their internal management approach.

We therefore recommend merging PAT-related requirements in ESRS 2 or in the topical standard per matter or per relevant combination of topics (for example, environmental or S2-S4 umbrella), while still allowing preparers to drill down to the appropriate level of granularity where necessary.

This approach would enhance the relevance of disclosures, support a more coherent presentation of material information, and better reflect integrated strategies. Reporting PAT at the matter level does not imply that all related topics and subtopics are material.

Additional reliefs

a) *Acquisition/disposal*

Following the principles set out in IFRS 3.45 on business combinations, flexibility should be introduced in cases where the initial accounting for an acquisition is incomplete at the end of the reporting period. A transitional period, not exceeding 18 months, should be allowed before the full integration of the acquired undertaking into the reporting and DMA and reporting scopes (reflected in ESRS 1 §BP).

b) *Aggregation and disaggregation*

Undertaking applying the ESRSs should take into account all relevant facts and circumstances to determine appropriate levels of aggregation or disaggregation in their sustainability disclosures. Aggregation/dis-aggregation must not obscure material information by combining dissimilar elements, nor should immaterial information dilute what is material. The goal is to preserve clarity, provide flexibility on presentation for preparers and ensure that users can properly interpret key messages.

Presentation of the sustainability reporting

The ESRS currently set out requirements regarding the presentation of sustainability reporting. As part of the ESRS simplification, we believe this aspect should also be addressed by allowing entities greater flexibility in how they present sustainability information within the sustainability statement, provided that disclosure requirements are met (i.e., alignment with the management practices). In line with this principle, for example, an entity could be permitted to provide users with a dedicated section that summarises the main contents of the sustainability reporting.

Interlinkage with the review of SFDR

The ESRS should remain the primary source of corporate sustainability data for financial market participants, while ensuring consistency and efficiency across the EU's sustainable finance framework. Almost all SFDR Principal Adverse Impact (PAI) indicators can be derived from the ESRS, either directly or indirectly – through ratio calculations, adjustments to definitions, and extraction of narrative disclosures on policies. Therefore, it does not seem necessary for the ESRS to include all SFDR PAI indicators as explicit datapoints, as some of the required information can be reconstructed by financial market participants from the ESRS disclosures or from proprietary data on their investment portfolios.

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Financial institutions specificities

The current sector agnostic ESRS are primarily designed for non-financial undertakings, rather than for financial institutions. As a result, several formulations within the standards are not adequately suited for financial sector undertakings, in particular due to the nature, importance, and specific characteristics of their investment, financing, or underwriting portfolios. Likewise, certain datapoints and methodologies require specific adaptations to reflect the operational realities of banks, insurance undertakings, and asset managers. It may be appropriate to explore, whether and how, this gap could be addressed in the simplification of the ESRS.

Principle of simplified presentation of the standards

To improve clarity, usability, and consistent implementation of the standards, the following simplifications are proposed:

- use more straightforward wording throughout the standards,
- significantly reduce the length of the text, notably by removing overly detailed general principles and by simplifying narrative sections deemed overly technical or detailed,
- introduce clarifications where concepts remain ambiguous (e.g., definitions of "reasonable effort" or "undue cost and effort") to facilitate consistent implementation,
- restructure the "application requirements" so as to not have any additional requirements outside the standards themselves. Consequently, also rename the content left in the "application requirements" into "application guidance" and it should be limited to key presentation aspects, essential methodological clarifications or additional voluntary "may-datapoints". The application guidance could for instance be positioned immediately after the disclosure requirements or outside the main body of the standard, and
- clarify regulatory references through footnotes, where appropriate.

Strengthening interoperability with the ISSB global baseline

The ISSB and EFRAG have already made significant efforts to ensure interoperability between the ESRS and the ISSB Standards. As the ESRS are being revised, it is essential to preserve the high level of interoperability that has already been achieved and to further strengthen the alignment by incorporating, where appropriate, ISSB language and content into the ESRS.

We also believe that EFRAG should continue to actively contribute to the ISSB's work on amending the SASB standards, with a view to ensuring their relevance and applicability in the European context.

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