

Mairead McGuinness
Commissioner for Financial Services, Financial Stability and Capital Markets
Union, European Commission

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Dear Commissioner McGuinness,

EFAA Response to the EFRAG Public Consultation on the First Set of Draft ESRS

EFAA appreciates the opportunity to provide our comments on the [public consultation on the first set of draft European Sustainability Reporting Standards \(ESRS\)](#). Our response has been prepared with input from our [Accounting, Assurance and EU Professional Regulation expert groups](#).

The European Federation of Accountants and Auditors for SMEs (EFAA) represents accountants and auditors providing professional services primarily to small and medium-sized enterprises (SMEs) both within the European Union and Europe as a whole. Constituents are mainly small practitioners (SMPs), including a significant number of sole practitioners. EFAA's members, therefore, are SMEs themselves, and provide a range of professional services (e.g., audit, accounting, bookkeeping, tax, and business advice) to SMEs. EFAA represents 15 national accounting, auditing, and tax advisor organisations with more than 380,000 individual members.

Basis for Our Response

Many SMEs, and the SMPs supporting them through the provision of advisory, accounting and assurance services to them, stand to be impacted directly or indirectly, by the CSRD and EFRAG's ESRS. Our response is focused on the impact and implications for SMEs and SMPs. And our response is principle-based. We respond only to those sections and questions of the survey most relevant to our constituents and on which we have an informed view. Accordingly, you will see we have responded to Section 1A (all questions), Section 1B (all questions), Section 1C (Q38), and Section 2 (all questions). In this cover letter we highlight our main points.

Sustainability

EFAA for SMEs believes sustainability - and climate change in particular - to be the most important issue and challenge of our time. We welcome the Green Deal. We welcome the commitment and ambition of its architects. And we welcome the Corporate Sustainability Reporting Directive (CSRD)'s embrace of SMEs. Sustainability is not just relevant to large companies. Collectively SMEs account for the majority share of private sector sustainability impact. So, they cannot, they must not, be left behind or ignored. Accordingly, EFAA welcomes the CSRD and its intent. And we welcome, in principle at least, the development of ESRS.

The pace of change is unprecedented. Sustainability reporting has emerged from the shadows into the spotlight, from margin to mainstream, in a fraction of the time financial reporting developed. And this type of reporting is, arguably, more complex, more controversial, more contentious, than financial reporting. We feel that the pace of change is too fast. We need to walk before we run. We need to prioritize and phase in while ensuring proportionality and scalability.

Due Process

We have reservations around due process. While we understand the need for some urgency, and that deadlines are to some extent determined by EU politicians and regulators, as manifested in the final CSRD, we feel that EFRAG has tried to do too much, too soon. EFRAG seems to be attempting in the first set of ESRS to have 'state of the art' standards – as perfect, technically rigorous, and comprehensive as they can make them within the tight time constraints imposed by the CSRD. We much prefer, and advocated for it to no avail, the 'think small and simple first' approach to standard setting, gradually building in the necessary complexity and comprehensiveness in due course. This would have lent itself to better due process. It would have given those less well equipped to respond in full to complex public consultations like this, such as SMEs and SMPs, the time to properly evaluate the proposals.

Capacity of SMEs and SMPs

The rapid emergence of sustainability reporting – and the ambition to place it on par with financial reporting – is an essential enabler to the achievement of sustainability objectives such as Net Zero. But becoming sustainable and reporting on it presents enormous challenges for SMEs as well as the SMPs that advise them, that prepare reports for them, that provide assurance on those reports. Right now, SMEs lack the capacity to become sustainable, let alone produce sustainability reports or respond to requests for sustainability information from larger companies in their value chain – and we doubt they will have the capacity anytime soon. Hence, we must ensure SMEs are given the time to build that capacity and that ESRS are proportional.

Proportionality

The structure and articulation of the cross-cutting ESRS appear to support the coverage of CSRD topics and reporting areas. However, we have serious doubts as to whether the draft ESRS adequately reflect the final text of the CSRD with respect to SMEs ‘caught’ in the value chain.

While we are concerned not to overburden companies within direct scope of the CSRD, including listed SMEs and other large companies that are not presently within the scope of the NFRD, our primary concern is the indirect impact of new reporting requirements on unlisted SMEs that are in the value chain of companies within scope. We fear that these SMEs will be asked to supply extensive sustainability information, by way of reports or the completion of questionnaires, that will be difficult and costly to supply, if not impossible anytime soon.

While it is important SMEs become more sustainable, it is vital we do not overburden them. SMEs, and the SMPs supporting them, need time, resources, and access to the tools that will enable them to manage their own sustainable transition as well as supply the necessary data to companies in the large companies in their value chain. We are, therefore, encouraged to see the addition of Article 29b Sustainability reporting standards for SMEs which states:

“2b. Standards shall also take account of the difficulties that undertakings may encounter in gathering information from actors throughout their value chain, especially from those which are not obliged to report sustainability information pursuant to Article 19a or 29a of this Directive and from suppliers in emerging markets and economies. Standards shall specify disclosures on value chains that are proportionate and relevant to the scale and complexity of the activities, and the capacities and characteristics of undertakings in value chains, especially those of undertakings that are not subject to the sustainability reporting obligations of Articles 19a or 29a of this Directive. Standards shall not specify disclosures that would require undertakings to obtain information from small and medium-sized undertakings in their value chain that exceeds the information to be disclosed according to the sustainability reporting standards for small and medium-sized undertakings referred to in Article 29c.”

We believe the draft ESRS fail to meet the test of proportionality and relevance as the CSRD describes. Moreover, the SME standard will likely not be ready until 2023. This warrants an urgent solution. As a temporary, or more permanent, measure the information required could be aligned with that in the standard for unlisted SMEs that might be ready in time.

We eagerly await the outcome of the cost-benefit analysis which includes a survey that aims to collect the inputs to determine the costs and benefits for undertakings in the value chain of undertakings with a requirement to prepare a sustainability report. We anticipate this will provide evidence in support of EFRAG making modifications, in particular simplifications to achieve proportionality, to the draft ESRS.

Materiality

We believe there is a need for considerable simplification of materiality and its application in the ESRS. Presently it is far too complex and burdensome for larger undertakings with some familiarity with sustainability reporting, let alone smaller undertakings, first-time reporters, and SMEs in the value chain. We suggest that the materiality assessment be performed at the topic, or sub-topic level, rather than at individual impacts of DR. This will provide more useful information. We also believe there is a need for more guidance, including illustrative examples, for materiality, presented either in the application guidance section or in a separate guidance document.

If the materiality assessment is done properly then it will render the rebuttable presumption redundant. The rebuttable presumption is burdensome. Undertakings will have to report, or else provide reasons and “reasonable and supportable evidence” for not reporting, for many immaterial DR. This burden will also cascade down on smaller undertakings in the value chain. Hence, it will fail to support relevant, accurate and efficient documentation of the results of the materiality assessment. It needs to be eliminated.

In its place we suggest having a limited set of mandatory material sustainability DR, for DR that are indeed material for all, or the large majority, of companies across all sectors (e.g., carbon emissions), supplemented by a longer list of voluntary or optional DR that the undertaking can consider as part of the materiality assessment. We also suggest EFRAG consider using the undue cost or effort exemption for specific requirements, a concept that has proven effective in the IFRS for SMEs, for specific DR.

Reporting Boundary and Value Chain

We are pleased that the CSRD has ‘capped’ value chain information to what is to be required by the sustainability reporting standard for listed SMEs. However, it would be even better if, the CSRD permitting, the information could be capped at what is outlined in the standard under development for unlisted SMEs (see below). We also appreciate the introduction of value chain transition provisions in Article 19 a, (3) which states:

“For the first three years of the application of this Directive, in the event that not all the necessary information regarding the value chain is available, the undertaking shall explain the efforts made to obtain the information about its value chain, the reasons why this information could not be obtained, and the plans of the undertaking to obtain such information in the future.”

We welcome the possibility of undertakings making widespread use of approximations to avoid overburdening unlisted SMEs with requests for information that will prove costly for them to provide. In many, if not most, instances approximations will provide information that is sufficient. We suggest EFRAG leave it for undertakings themselves to determine how best to get information from their value chain, whether by direct request, approximations, or some other way. Approximations ought not be ‘last resort’ method, only for use

when it is impractical for them to get it directly, but rather the preferred method in many cases. Guidance may also be necessary on how to develop the approximations.

EFRAG might also consider phasing-in the value chain information covering, say, in the first three years through to the first review of the ESRS only those undertakings under the control of the in-scope undertakings. This would allow undertakings, especially smaller ones, time to build the capacity to capture the required data to satisfy requests from in scope undertakings. This phase-in could be based on levels of control and influence the undertaking exercises over undertakings in its value chain – full control, influence and other.

ESRS could be simplified even further by deferring the requirement for value chain disclosures until the ESRS are first reviewed. Finally, we suggest EFRAG consider using the undue cost or effort exemption, commonly used in the IFRS for SMEs, for value chain reporting for all or some specific DR.

Prioritization and Phasing-In

All the sustainability topics and subtopics addressed by ESRS are important and equally deserving. Some topics, however, are more urgent than others and / or more feasible to report on. The CSRD does not mandate comprehensive disclosure for all topics from the outset. This gives EFRAG much latitude to prioritize and phase-in. While we support coverage of all sustainability topics in core ESRS, we believe prioritization and phasing-in is essential. We believe climate change (ESRS E1) is the most urgent topic and as such demands to be prioritized and phased-in ahead of other topics. We might start with the most important DR for the largest companies in all sectors, then gradually adding DR within each ESRS, and finally require value chain disclosures.

We suggest phasing in over a period of three years as many companies, especially the smaller undertakings within scope of the CSRD, first time reporters and those in the value chain, will need time to build the capacity to report.

Interoperability with Global Standards

While we support the development of ESRS, as these are tailored to the needs of European economy and society, we believe global harmonisation to be desirable. As such we support the development of a global baseline by the International Sustainability Standards Board (ISSB) line to accommodate regional variations, provided they align in all fundamental respects. As such we support the development of a global baseline by the International Sustainability Standards Board (ISSB) and support IFAC's position as set out in its draft responses to the [sustainability-related disclosures consultation](#) and the [climate-related disclosures consultation](#). We believe that this global baseline must be sufficiently flexible and generic to allow for regional standards like ESRS. Global and regional standards such seek to converge as far as possible through a process of co-construction and by pursuing those standards that are most developed and where there is the greatest consensus. We also believe that, as far as possible, ESRS should be no more burdensome than their ISSB

equivalents. Departures from the global baseline should only be justified to ensure ESRS conform with prevailing EU law and agreed policy objectives.


Sustainability Standards for SMEs

When EFRAG first started preparing for the development of ESRS, we advocated for SMEs to be carefully considered from the outset rather than ‘onboarded’ in the future. We figured it best to avoid repeating the experience of financial reporting – notably IFRS and IFRS for SMEs - where efforts to accommodate SMEs were only made after it became clear a ‘one size fits all’ approach to standards did not work for SMEs. We ended up with a global SME standard regarded as too complex for EU SMEs. The CSRD, which stands to impact the millions of unlisted SMEs not within direct scope of the directive through the value chain, makes it even more important to have sustainability reporting standards for SMEs. Such standards would also encourage voluntary reporting by SMEs.

We therefore look forward to the development, as soon as practicable, of sustainability reporting standards for SMEs, as envisaged by Article 29c of the CSRD. We understand EFRAG plans to issue as part of set 2 of ESRS SME standard(s) in late 2023. We believe this is too late. Hence, we strongly encourage EFRAG to adopt the sustainability reporting standard for unlisted SMEs that has been developed by Cluster 8 - SMEs of the former EFRAG PTF-ESRS. This draws on the Nordic Sustainability Reporting Standard. EFRAG may have to develop two separate standards – a mandatory one for listed SME and a voluntary for other SMEs – or else a modular standard with a ‘core’ module applicable to all SMEs. Whatever approach is taken we hope that Cluster 8’s proposal is recognized as providing information sufficient to satisfy requests coming through the value chain.

We greatly appreciate this opportunity to share our points of view and look forward to supporting you. For more information on our sustainability-related activities please visit our micro-site [here](#).

Yours sincerely,



Salvador Marín
EFAA President



Paul Thompson
EFAA Director