Template for comments on draft ESRS Delegated Act

The draft delegated on European Sustainability Reporting Standards (ESRS) comprises: the main text of the legal act; twelve draft standards (annex I); and a glossary of abbreviations and defined terms (annex II).

The twelve draft standards in Annex I are:

Group	Number	Subject
Cross-cutting	ESRS1	General Requirements
Cross-cutting	ESRS2	General Disclosures
Environment	ESRS E1	Climate
Environment	ESRS E2	Pollution
Environment	ESRS E3	Water and marine resources
Environment	ESRS E4	Biodiversity and ecosystems
Environment	ESRS E5	Resource use and circular economy
Social	ESRS S1	Own workforce
Social	ESRS S2	Workers in the value chain
Social	ESRS S3	Affected communities
Social	ESRS S4	Consumers and end users
Governance	ESRS G1	Business conduct

Each standard is divided into numbered paragraphs. Each standard also has an appendix A containing “application requirements” which are numbered as AR 1, AR 2 etc. Some standards also contain additional appendices.

To facilitate analysis of comments, respondents are kindly requested to use the simple template below when sending their comments.

Name of respondent/responding organisation: EFAA for SMEs

1. General comments

EFAA appreciates the opportunity to provide our comments on the European Commission (EC) Consultation on the European sustainability reporting standards (ESRS) – first Set. While the four week consultation period has presented us significant challenges in compiling a robust response, a challenge exacerbated by the extent of the many changes the EC has made to the draft standards it received from EFRAG, we fully recognize the EC has good justification for this. We strongly support the timely and robust development and implementation of the ESRS. And we strongly support the EC's efforts to simplify this first set of ESRS and EFRAG's timely development of implementation guidance. We believe the EC has struck a reasonable balance between ambition and pragmatism.

Notwithstanding our support, we continue to have concerns about the indirect impact of the ESRS on non-listed SMEs. This impact is primarily the consequence of applying impact materiality through value chain reporting. We believe this will impede the Commission's desire to reduce the reporting burden on companies, especially SMEs, by 25%. Accordingly, we question whether there is a need for more support for non-listed SMEs that are in the value chain of in scope companies. We elaborate on these concerns and the potential additional action and support to address them below. We recognize that non-listed SMEs are instrumental to the timely sustainable transition of the EU economy and but that they need help and time if they are to play their full part in this transition.

About EFAA

The European Federation of Accountants and Auditors for SMEs (EFAA) represents accountants and auditors providing professional services primarily to 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 currently represents 15 national accounting, auditing, and tax advisor organisations with more than 380,000 individual members.

EFAA Role in Sustainability Reporting

In November 2022, despite acute resource challenges and extreme time pressure, EFRAG successfully delivered the first set of draft ESRS to the EC. EFAA applauds EFRAG for this accomplishment. EFAA, primarily through its membership on the Sustainability Reporting Board (SRB) representing SMEs and the SMPs that typically help these SMEs prepare their corporate reports, played a part in this accomplishment. EFAA is committed to continue to help EFRAG and the EC develop and implement the ESRS as these standards are critical and instrumental to the timely realization of Europe's sustainable transition.

Realizing Europe's sustainable transition requires companies to gain an understanding of their sustainability impacts and performance *and* to publish robust reports on their sustainability impacts and performance so that one can determine whether they are making sufficient progress. Consequently, it is vital that companies start reporting as soon as is practicable and that appropriate steps are taken to onboard SMEs. Accordingly, we are pleased to share our remarks on the draft Set 1 ESRS in this response document. We remain at the EC disposal for any additional input or clarification.

Cost-Benefit Impact

EFAA is concerned to ensure that policy, regulation, and sustainability reporting standards are scalable and proportionate to the capacities of SMEs, especially the millions of non-listed ones across the EU, and their SMP accountants, while tailored to the needs and characteristics of SMEs and SMPs. We strongly prefer a 'Think Small First' approach, developing straightforward regulation and standards for SMEs and SMPs and then scaling up to suit larger more complex companies and practices.

Not surprisingly we strongly agree with President von der Leyen's remarks during her speech at the European Parliament Plenary of 15 March 2023 on the preparation of the European Council meeting of 23-24 March 2023 in which she announced plans to simplify corporate reporting requirements and reduce the implementation burden for SMEs. In the coming months we look forward to seeing the EC's proposals to simplify reporting requirements and reduce them by 25%. We have already shared some ideas with the EC in this letter. The introduction from 2025 of sustainability reporting will make achieving these objectives much harder to achieve.

Guidance for SMPs

EFAA's commitment to play its full part in helping SMEs and SMPs prepare for sustainability reporting is clearly demonstrated by two guides we have recently issued - Sustainability Reporting: How SMPs Can Build the Capacity to Support SME and Sustainability Reporting Assurance: How SMPs Can Build the Capacity to Support SMEs. These offer guidance to SMPs on how they can get ready to prepare sustainability reports for their SME clients and provide assurance on such reports. We are facilitating their translation and are committed to periodic revision to keep them up to date. While guidance is useful, there is an acute need for education and training of professional accountants in sustainability advisory, reporting, and assurance. Many professional accountancy organizations (PAOs), including EFAA member organizations, are starting to roll out education and training initiatives. Much more will be needed.

Application and Implementation of ESRS

We reiterate our call to the EC to ensure that EFRAG has sufficient resources to support the application and implementation of ESRS.

EFAA welcomes the EC'S request that EFRAG focus on implementation of the Set 1 ESRS and EFRAG's commitment to and progress made on various implementation support initiatives. We note that the EFRAG SRB has already discussed initial drafts of implementation guidance for materiality and value chain reporting. EFAA has urged EFRAG to address the value chain implementation guidance **both** to in scope companies that will request (demand) the information of non-listed SMEs in their value chain (to ensure they ask no more than is required) **and** to non-listed SMEs that receive requests (demands) (to ensure they can push back on requests that go beyond what is required). EFAA is urging EFRAG to include examples, illustrations, reporting templates, and a value chain mapping so that SMEs, especially non-listed SMEs, can see what will be asked of them. Ilustrations tailored for non-listed SMEs should be integrated into all guidance EFRAG publishes.

While guidance is welcome the EC and EFRAG will need to lead a range of capacity building activities. The International Sustainability Standards Board (ISSB)is worth emulating in this regard. There is an urgent need for illustrative and practical examples as well as a comprehensive suite of educational materials. These materials need to address non-listed SMEs in the value chain of companies in scope. We are available to continue to support EFRAG and to contribute to a fruitful discussion.

Sustainability Reporting Standards for SMEs

It is vital that the SME standards, the ESRS for listed SMEs (LSME ESRS) and the voluntary sustainability reporting standard for use by non-listed SMEs (VSME) are developed on a timely basis. We recognize that the CSRD has determined that the LSME ESRS will serve to set a cap on what information larger companies can demand of companies in their value chain (see our specific comments under 2 below on the value chain). Similarly, these standards need to be sufficient for fulfilling information needs of financial institutions investing in or extending credit to SMEs. The standards themselves, EFRAG's implementation guidance, and official communications around the standards should reinforce the point that the LSME ESRS reflects best practice reporting for value chain purposes to mitigate the risk that in scope companies will demand too much information from non-listed SMEs in their value chain. While we strongly prefer that the cap be based on the VSME, we understand that the CSRD as adopted makes this impractical.

We strongly encourage the EC to work with EFRAG to expedite the development of the proposed voluntary sustainability reporting standard for SMEs (VSME). The proceedings of recent EFRAG SRB meetings and remarks by Sven Gentner and Patrick Cambourg at the 27 June 2023 meeting of the EP Committee on Legal Affairs suggest the EC plans to do so. Non-listed SMEs, many of them micro-entities, constitute a vast majority of SMEs by number. Furthermore, in aggregate their economic size and ESG impact is far greater than that of listed SMEs. Accordingly, we believe the VSME will be critical to including non-listed SMEs in the EU's sustainable transition. We therefore urge the EC and EFRAG to publicly consult on the draft VSME in parallel with the LSME ESRS. We hope this draft standard will draw heavily on the draft standard produced by the extant Cluster 8 SME of the PTF-ESRS. In this way non-listed SMEs will gain awareness of the sustainability reporting requirements and their trickle-down effects on non-listed SMEs. The VSME needs to be developed from first principles using a 'Think Small First' approach rather than a simplification of the ESRS applicable to in scope companies. The VSME should be designed to help those SMEs that are motivated to voluntarily report and to serve as a sustainability performance management tool. The VSME should ideally be drafted using a vernacular that is readily understood by the SME owner-manager and their accounting staff and / or principal advisors (SMPs). This may demand departing from the precise technical language and sentence construction of the ESRS. The first set of ESRS are written in a style and language most suited to and understood by more sophisticated preparers including large, listed companies and large audit firms.

In addition, incentives must be provided for SMEs to adapt to this culture and to report on a voluntary basis, therefore we call for a public budget to be established for this purpose by the EU.

Technology Enablers

We are hopeful that high quality affordable technological tools will be made available to help companies implement sustainability reporting standards as well as respond to requests for information from companies in their value chain. AI tools might be especially useful given their ability to work with text and qualitative information. We strongly encourage the EC to play a leading role in promoting the development of such tools for example, accreditation / certification of tools that are ESRS compliant, creating a catalogue of suitable tools, running a competition for the best tools etc.

Proxy Data

Similarly, we strongly encourage the EC to play a leading role in providing suitable proxy data for companies to use, especially for value chain reporting. This would lend legitimacy to the use of such data, often seen as a last resort in case direct data cannot be obtained, ease the reporting burden of companies, and foster greater consistency of reporting as many companies use the same source of data.

Post Implementation Review (PIR)

We recommend that the EC and EFRAG commit to a comprehensive post-implementation review of the first set of ESRS with a strong emphasis on the impact of value chain reporting on non-listed SMEs. PIR are standard practice for international standard setters. Moreover, a PIR is especially important given the necessary haste with which the ESRS have been developed, the inherent limitations of the cost-benefit analysis (see our remarks under 2 below), and the lack of proper field testing with non-listed SMEs. A PIR may identify the need for changes to the ESRS. Furthermore, as companies go about implementing the ESRS in the coming few years EFRAG and the EC need to be alert to any significant problems encountered and take action in a timely manner rather than wait for the outcome of a PIR.

2. Specific comments on the main text of the draft delegated act

Value Chain

We note that at the top of page 2 (3 of the pdf) there is an explanation of how the ESRS should deal with the value chain. We welcome the effort to ensure the ESRS accommodates non-listed SMEs in the value chain. However, despite the introduction of various reliefs such as transitional provisions,

phase-ins and substitutes for direct data, value chain reporting will continue to present vast numbers of non-listed SMEs with a significant challenge. Many non-listed SMEs have little or no awareness of what is coming. And many of those that are aware will need to commit considerable resources into building the capacity -specifically the reporting systems to identify, capture, and record high quality information - to meet requests for information from in scope companies. We are also concerned that in scope companies and non-listed SMEs in their value chain will not be fully aware of the various reliefs designed to ease the impact on non-listed SMEs in the value chain. Second, we are concerned that non-listed SMEs will, at least initially, find it difficult except at exorbitant cost to supply the sustainability information demanded of them by in scope companies. Companies may demand information that is over and above, or sooner, than as required by ESRS (ESRS "may not specify disclosures that would require undertakings to obtain information from SMEs in their value chain that exceeds the information to be disclosed pursuant to the sustainability reporting standards for SMEs." – as we state above if the CSRD allows then we urge the EC to consider setting this cap at the level of reporting in the VSME.). And companies may threaten to terminate business relationships with non-listed SMEs that fail to supply this information. These concerns prompt us to recommend that the definition of the value chain be narrowed for an initial period by **either** only including Tier 1 suppliers **or** by excluding non-listed SMEs beyond Tier 1. We elaborate on this in the next section (see comments under 3 below) Cost-Benefit Analysis We note that at the bottom of page 4 (5 of the pdf) there is a brief description of EFRAG's cost-benefit analysis on the first set of draft ESRS. Given significant concerns about the cost-benefit impact on non-listed SMEs, and the lack of persuasive evidence to the contrary, the SRB representative representing SMEs and SMPs abstained from voting in support of EFRAG's cover letter on the cost-benefit analysis. We suggest, therefore, that the EC consider elaborating on the inherent limitations of the analysis, in particular the fact that insufficient evidence on the impact on non-listed SMEs through value chain reporting was obtained to draw meaningful conclusions. We believe that a good cost-benefit analysis, involving a larger sample of SMEs and SMPs, will provide arguments in favour of voluntary use by SMEs as well as important evidence to develop the information requirements requested by the value chain application. Further evidence will be added on the necessary incentives.

3. Specific comments on Annex I

Standard	Paragraph or AR number or appendix	Comment
ESRS 1	*Section 3.4, Para 43-46*	We welcome the fact that all disclosure requirements and data points within each standard, except for ESRS 2, will be subject to materiality assessment by the undertaking. This measure is expected to lead to a significant reduction in the

		burden of reporting for companies and helps to ensure that the standards are proportionate. Paragraph 43 says that impact materiality extends to "the undertaking's own operations and value chain, including through its products and services, as well as through its business relationships, and that business relationships include those in the undertaking's upstream and downstream value chain and are not limited to direct contractual relationships". This is a very broad interpretation of the extent of the value chain that seems to span the entire upstream and downstream value chain. We suggest the definition be narrowed. See our comments on Section 5.1 below).
ESRS 1	*Section 5 1, Para 62-67*	Paragraph 63 explains that "the reporting undertaking provided in the sustainability statement shall be extended to include information on the material impacts, risks and opportunities connected with the undertaking through its direct and indirect business relationships in the upstream and / or downstream value chain ("value chain information")." This is a very broad interpretation of the extent of the value chain that spans the entire upstream and downstream value chain. While paragraph 64 clarifies that this "does not require information on each and every actor in the value chain, but only the inclusion of material value chain information" it does appear to mean that in scope companies will need to conduct an impact materiality assessment throughout the entire value chain. This means that next year these companies, even though the ESRS allows them up to three years to comply, will likely ask for information from the many non-listed SMEs in their value chain so that they can determine material impacts, risks, and opportunities in their value chain. We predict this will be especially difficult for ESRS S2 Workers in the value chain. These companies lack the capacity to provide the relevant information or only do so at prohibitive cost. We suggest, therefore, that the EC, if the CSRD allows (we understand there is reference to "the whole value chain"), consider amending the definition of value chain for an initial period of, say, three years, by **either** limiting it to Tier 1 suppliers (that is, partners that a company directly conducts business with, including contracted manufacturing facilities or production partners) **or** by excluding non-listed SMEs beyond Tier 1. After three years the boundary of the value chain can be extended to all companies in the value chain.
ESRS 1	*Section 5.2, Para 68-72*	We welcome the ESRS recognizing that there will be circumstances where the company cannot collect the information about its upstream and downstream value chain required by paragraph 63 after making reasonable efforts to do so and in these circumstances the company can 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. For the sake of easing the burden on non-listed SMEs in the value chain it is vital that companies take advantage of this opportunity. Furthermore, the ESRS should avoid giving the impression that proxies are inferior to direct data and only to be used as a last resort when all else fails. . We believe that in some circumstances they can improve the quality of

		reporting and so be preferred. Accordingly, the ESRS might encourage their use. Non-listed SMEs also need to be made aware of the fact that the ESRS provide this opportunity. In this way it may limit the likelihood of companies pressuring non-listed SMEs in their value chain to provide direct data when it would be prohibitively expensive or impractical to do so. This ought to be articulated in the value chain implementation guidance under development by EFRAG. This guidance should also provide examples of suitable sources of sector-average data and other proxies. In our general comments under 1 above we encourage the EC plays a leading role in providing suitable proxy data for companies to use, especially for value chain reporting, on the basis that this would lend legitimacy to the use of such data, ease the reporting burden of companies, and foster greater consistency of reporting.
ESRS 1	*Section 10.2, Para. 131-133*	We welcome the relief this transitional provision– value chain reporting can be phased in for the first three years, irrespective of their size – but suggest that it be given greater prominence and promoted as good practice. It is vital that in scope companies be encouraged to give companies in their value chain, especially non-listed SMEs, the time to build the capacity to provide the necessary information. These SMEs need to be alerted to the fact that the ESRS grant them this time to prepare for value chain reporting. EFRAG's value chain implementation guidance should stress the existence and encourage use of this phase in provision.
ESRS 1	*Appendix C*	While we welcome the phasing in of disclosure requirements, we urge the EC to consider further phasing in. We suggest limiting the application of impact materiality and value chain reporting to time critical sustainability issues, most notably climate change, for a period of up to three years, and deferring other issues.
ESRS E1-G1		We have no comments on these ESRS.

4. Specific comments on Annex II

Defined term	Comment
	We have no comments except to say that these must be closely aligned with ISSB equivalents.
Actors in the value chain	See remarks above under sections 1, 2 and 3 regarding how the value chain is defined.