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Sven Gentner
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Sven.GENTNER@ec.europa.eu; FISMA-C1@ec.europa.eu

Re: Commission Notice on the Interpretation of the CSRD and the ESRS 13 November 2024 (Frequently Asked Questions – FAQs)

Dear Mr. Gentner,

We would like to welcome the issuance by the European Commission of the Commission Notice on the Interpretation of the CSRD and the ESRS of 13 November 2024 (Frequently Asked Questions – FAQs) – hereinafter referred to as the “FAQs”. Given the difficulty that both preparers and assurance practitioners are having with the interpretation of the CSRD and the ESRS, the FAQs provide useful guidance to these parties seeking to apply the CSRD and the ESRS.

We note that with the issuance of the FAQs, it is the stated intention of the Commission to facilitate compliance with EU regulatory requirements and to foster useability and comparability of sustainability information reported. We also note the assertion in the FAQ by the Commission that the FAQs “do not extend in any way the rights and obligations deriving from such legislation nor introduce additional requirements”. We are writing this letter to you because we believe that in at least three interrelated crucial areas in connection with the assurance conclusion (called “opinion” in the CSRD and the FAQs) provided by the assurance practitioner, the FAQs go beyond the obligations arising from the CSRD and the ESRS by suggesting the existence of additional requirements for assurance practitioners that provide assurance reports on sustainability reports in the EU.

GESCHÄFTSFÜHRENDER VORSTAND:
Melanie Sack, WP StB, Sprecherin des Vorstands;
Dr. Torsten Moser, WP;
Dr. Daniel P. Siegel, WP StB

Amtsgericht Düsseldorf
Vereinsregister VR 3850

All three of these issues arise in Section V – "FAQs on the assurance of sustainability reporting", Subsection "Assurance of the Sustainability Statement Prepared In Accordance With Articles 19a and 23 Accounting Directive", Question 70 "What should the assurance provider express an opinion on, according to Article 34 (1) of the Accounting Directive?".

To clarify our concerns, we quote the assurance opinion required by the CSRD:

> "… where applicable, express an opinion based on a limited assurance engagement as regards the compliance of the sustainability reporting with the requirements of this Directive, including the compliance of the sustainability reporting with the sustainability reporting standards adopted pursuant to Article 29b or Article 29c, the process carried out by the undertaking to identify the information reported pursuant to those sustainability reporting standards, and the compliance with the requirement to mark up sustainability reporting in accordance with Article 29d, and as regards the compliance with the reporting requirements provided for in Article 8 of Regulation (EU) 2020/852"

Assurance opinion on the process to identify the information to be reported.

The **first issue** relates to the assurance opinion in relation to the process to identify the information to be reported. The opinion under the CSRD relates to

> "… the process carried out by the undertaking to identify the information reported pursuant to those sustainability reporting standards…".

In contrast, in the first dash of the last paragraph answering Question 70, the FAQs state

> "… whether the undertaking's sustainability statement, including the process to identify the information reported …, <u>are compliant with ESRS</u>…".

In the text of the practitioner's opinion under the CSRD, the words "including the compliance of the sustainability reporting with the sustainability reporting standards" <u>*are prior*</u> to the required opinion on the process, whereas in Question 70 of the FAQs, the words "are compliant with ESRS" <u>*are after*</u> the required opinion on the process.

Consequently, this sentence in the FAQs is requiring an explicit opinion on <u>the compliance</u> of the process to identify the information reported <u>with the ESRS</u>, whereas the CSRD only requires an explicit opinion on the process <u>carried out</u> by the undertaking to identify the information reported pursuant to the ESRS. In other words, the latter explicit opinion as set forth in the CSRD extends only to the evaluation of whether the process carried out pursuant to the ESRS is correctly described in the sustainability statement (as required by the ESRS) – not whether that process is in compliance with the ESRS.

Nevertheless, we understand that the compliance of that process with the ESRS is subsumed under the general opinion required by the CSRD "… as regards the compliance of the sustainability reporting with the requirements of this Directive…" and is also subsumed under further opinion "… including the compliance of the sustainability reporting with the sustainability reporting standards adopted pursuant to Article 29b or Article 29c…". At first glance, there does not appear to be a difference in substance between the explicit opinion and such a "subsumed assurance finding", but there is a substantial difference that arises from the different focus of an explicit opinion. An explicit opinion in all material respects as set forth implies that the materiality of departures in the process from ESRS would be determined by reference to the ESRS requirements for the process alone (i.e., a material departure in what was done in the process compared to what was required by each relevant requirement in the ESRS for the process), whereas the materiality of departures from the ESRS requirements for the "subsumed assurance finding" would be considered based upon the materiality of the impact of the departures on the compliance of the sustainability reporting required by the Directive and the materiality of the departures for the disclosure (as defined by ISSA 5000) "description of the process" as a whole.

This means that an explicit opinion may lead to smaller departures in the process from the ESRS requirements for the process being material and to greater work effort by assurance practitioners. Since undertakings are not required to make an explicit assertion in the sustainability report that the process that they described and have carried out is compliant with each of the requirements in the ESRS for the process, entities will determine the materiality of departures from the ESRS by reference to the materiality of the impact of the departures on the compliance of the sustainability reporting required by the Directive and the materiality to the overall description of the process. This implies that the explicit assurance opinion required of practitioners would lead to an additional level of granularity in what is material for undertakings through assurance requirements for assurance practitioners, which is inappropriate, because materiality should be driven by the reporting requirements – not assurance requirements. We therefore strongly recommend that the wording in the FAQ for the opinion on the process not depart from that set forth in the CSRD.

Assurance opinion on the outcome of the process

The **second issue** relates to the reference to the second dash of the last paragraph answering Question 70, in which the opinion entails an explicit opinion about "whether the outcome of this process has resulted in the disclosure of all material sustainability-related impacts, risks and opportunities of the undertaking in accordance with ESRS". We would like to point out that the opinion as set forth in the CSRD only extends to "… the compliance of the sustainability reporting with the requirements of this Directive, including the compliance of the sustainability reporting with the sustainability reporting standards…". Such compliance involves the undertaking having a process, in accordance with ESRS, to identify the information to be reported. However, the ESRS provide substantial leeway to undertakings in their design and implementation of such a process, which is why the ESRS require undertakings to describe that process, so that users can understand that process when evaluating the information that the undertaking determines as needing disclosure. Similar undertakings may therefore legitimately have very different processes even when these are compliant with the ESRS, which may result in substantially different outcomes – that is, the material sustainability-related impacts, risks and opportunities disclosed for similar undertakings may differ in a very significant manner.

Practitioners therefore provide an opinion on whether the process actually undertaken was appropriately described in the sustainability statement (see the first issue above) and whether, based upon the outcome of that process, all material sustainability-related impacts, risks and opportunities identified by that process have been disclosed – not on whether the outcome resulted in the disclosure of all material sustainability-related impacts, risks and opportunities. The CSRD and the ESRS do not require that either management assert, or that practitioners provide an opinion on, whether all material sustainability-related impacts, risks and opportunities have been disclosed, independent of the process used by the undertaking to identify the information to be reported. By including such an opinion, the FAQs are also asking practitioners to provide an opinion that goes beyond the assertions made by management in the sustainability statement. Providing an opinion that goes beyond the assertions made by management is not appropriate because the assurance engagement on the sustainability statement – like an audit of financial statements – is an attestation engagement, which means that the assurance practitioner provides an opinion on what management has reported or ought to have reported – not beyond this.

Furthermore, by asking practitioners to provide such an opinion, the FAQs would be implicitly requiring practitioners to obtain assurance and opine on the design effectiveness and operating effectiveness of the process, which is not required by the CSRD, and which would be analogous to an opinion provided on internal control on financial reporting as required by the Sarbanes-Oxley Act Section 404 in the U.S. This does not imply that practitioners do not address the process as part of their engagement. For example, ISSA 5000 does require practitioners to obtain an understanding of that process as part of obtaining an understanding of the information system and communication and requires practitioners to evaluate whether the information system, including that process, appropriately supports the preparation of the sustainability information in accordance with the reporting requirements. Such an evaluation involves considerably less work effort (and hence considerably less cost) than the work effort that would be required in forming an assurance conclusion on the design and operating effectiveness of the process.

We recognize that among stakeholders there may be some misunderstanding about the nature of the opinion required in relation to the outcome of the process and the nature and extent of the work that practitioners are required to perform on the process, and this misunderstanding leads to an expectations gap. Nevertheless, the CSRD and the ESRS were written carefully in this respect to balance the needs of stakeholders with the concerns that the implementation of the CSRD be practicable for both undertakings and assurance practitioners.

For these reasons, we strongly recommend that the second dash in the last paragraph answering Question 70 be adjusted to reflect the wording in the CSRD and the ESRS.

Fair presentation opinion

The **third issue** relates to the assertion in the second to last and last paragraphs in the answer to Question 70 in the FAQs that assurance practitioners are required to perform procedures to conclude on the fair presentation of the sustainability statement and that the conclusion refer to "fair presentation, in all material respects". We believe that these statements in the FAQs put the "cart before the horse" – that is, it appears to us that the Commission is seeking to remedy an issue in the reporting requirements through requirements for the assurance practitioner. An opinion on the fair presentation of something does not depend on assurance requirements, but on the underlying requirements in the reporting requirements applicable to the undertaking – that is, the requirements applicable to management preparing the sustainability statement.

Management is subject to the reporting requirements in the CSRD and the ESRS. In that vein, we would like to point out that the fundamental qualitative characteristic of information "faithful representation" is not equivalent to the concept of "fair presentation", which is often misunderstood. We gather that the occasional ill-used reference to "faithful representation" as a proxy for "fair presentation" relates to the requirement for information to be complete as set forth in QC 5 of Appendix B of ESRS 1 and as further described in QC 6, which describes faithful representation as referring to

> "a complete depiction of an impact, risk or opportunity includes all material information necessary for the users to understand that impact, risk or opportunity. This includes how the undertaking has adapted its strategy, risk management and governance in response to that impact, risk or opportunity, as well as the metrics identified to set targets and measure performance."

We note that QC 6 refers to a complete depiction of "an impact, risk or opportunity" and "in response to "that" impact, risk or opportunity as well as "the metrics identified"". Consequently, faithful representation refers to the completeness of the information relating to an impact, risk or opportunity and to the metrics identified by the entity – not to whether the sustainability report as a whole includes all impacts, risks and opportunities and metrics not identified by the entity.

We would also like to point out that there is a difference between a fair presentation requirement and the requirement in paragraph 11 of ESRS 1. This paragraph states:

> "In addition to the disclosure requirements laid down in the three categories of ESRS, when an undertaking concludes that an impact, risk or opportunity is not covered or not covered with sufficient granularity by an ESRS but is material due to its specific facts and circumstances, it shall provide additional entity-specific disclosures to enable users to understand the undertaking's sustainability-related **impacts, risks** or **opportunities."**

In this case, the requirement to include additional disclosures beyond those laid out in the ESRS results from the undertaking concluding (that is, based upon the process to prepare the sustainability statement, including the process carried out by the undertaking to identify the information reported) – not further evaluating whether additional disclosures are necessary. It does not involve the undertaking taking further measures beyond its process to identify the information reported to seek to identify further material matters to be reported, unless the undertaking otherwise becomes aware of such information as part of its preparation process.

This is different from the requirement in the IFRSs, IAS 1 paragraph 15, for fair presentation, which addresses additional disclosures when necessary to fairly present the financial position, financial performance and cash flows of an entity. Paragraph 17 of IAS 1 further requires entities to provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. In this case, the IFRSs require entities to identify all transactions and other events and conditions to which the fair presentation requirement applies. In contrast, the requirement in paragraph 11 of ESRS 1 relates to additional disclosures to understand the undertaking's sustainability-related impacts, risks or opportunities – but not potentially all of these with a view to providing a complete view of these, but only those impacts, risks or opportunities as identified by the materiality assessment process set forth in the ESRS.

Since, as noted in our discussion of the second issue above, neither management asserts, nor the practitioner opines, on the disclosure of all material sustainability-related impacts, risks and opportunities independent of the process to identify the information to be reported, a fair presentation assertion by management and therefore a fair presentation opinion by the assurance practitioner are not applicable under the CSRD and the ESRS. As we noted above, there appears to be some misunderstanding among stakeholders about the role of the materiality assessment process in the preparation of sustainability statements and the assurance thereon that leads to an expectations gap about what sustainability statements can include. It simply isn't possible for a sustainability statement to meet the expectations of all potential stakeholders with respect to sustainability-related impacts, risks or opportunities, which is why a materiality assessment process is required in the ESRS.

Fair presentation also goes beyond faithful representation alone in requiring additional disclosures that are not required by the individual requirements of the reporting standards by reference to a "view" or presentation of something that is obtained on the basis of a "stand back" by management. This is important: "fair presentation" relates to the presentation of something – for a complete set of general purpose financial statements, as under IFRSs, this is often the presentation (or view) of the financial position, financial performance and cash flows. It is unclear as to exactly of what the CSRD and ESRS require fair presentation.

Furthermore, by asking, in the FAQs, assurance practitioners to opine on fair presentation, the FAQs are asking assurance practitioners to provide an opinion that goes beyond the assertions required of management in preparing the sustainability statement, which violates a fundamental principle of attestation assurance engagements: assurance practitioners opine on whether management has prepared the information in accordance with the reporting requirements (which in this case, do not require fair presentation, either explicitly or implicitly) – not on whether management has prepared the information using criteria that go beyond the reporting requirements. For this reason, we believe that references to “fair presentation” in the FAQs go beyond the CSRD and the ESRS and are therefore misplaced and ought to be deleted.

If the European Commission is seeking to have “fair presentation” addressed in a reasonable way within the confines of the current European legislation (in particular paragraph 11 of ESRS 1 and QC 5 and 6 of Appendix B of ESRS 1), then this could be done by:

- clarifying in the FAQ that management is required to fairly present the sustainability-related impacts, risks and opportunities of the undertaking <u>as identified by the process used to identify the information to be reported</u>
- clarifying that assurance practitioners provide an opinion on the fair presentation of the sustainability-related impacts, risks and opportunities of the undertaking <u>as identified by the process used to identify the information to be reported.</u>

Such an approach would be practicable for both undertakings and assurance practitioners.

Overall, we are deeply concerned that by going beyond the legislation passed by EU legislative bodies (the CSRD and the ESRS) in these matters, the FAQ undermines that carefully crafted legislation, which balances the needs of stakeholders with the need for the implementation of the CSRD to be practicable for undertakings and practitioners. It brings the legislative process at a European level into disrepute when non-binding instruments issued by EU authorities are not in compliance with the underlying legislation they are supposed to interpret – regardless of any good intentions and political imperatives. It is also inconsistent with the current objective of the European Commission to reduce unnecessary regulation rather than increase bureaucracy, including potential plans contemplated by the Commission to simplify sustainability-related regulation by means of a “omnibus regulation”.

We would be very pleased to discuss these matters with you at your convenience.

Yours sincerely,

Wolfgang Böhm	Bernd Stibi
Technical Director Assurance Standards	Technical Director
Director International Affairs	Financial & Sustainability Reporting