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[639/705]

Discussion Paper: The Connectivity of Financial and Sustainability Reporting

Dear Madam or Sir,

We thank you for the opportunity to comment on EFRAG's Discussion Paper: The Connectivity of Financial and Sustainability Reporting (hereafter: "DP").

The Institut der Wirtschaftsprüfer in Deutschland e.V. [Institute of Public Auditors in Germany, Incorporated Association] (IDW) is a privately run organisation established to serve the interests of its members who comprise both individual Wirtschaftsprüfer [German Public Auditors] and Wirtschaftsprüfungsgesellschaften [German Public Audit firms]. The IDW represents approximately 80% of all German Public Auditors. The auditing profession has not only historically played its part in assuring the quality of financial reporting but it now also plays an important role in the green transformation by supporting companies in the implementation of their ESG initiatives and by providing high-quality assurance services in respect of sustainability reporting. Accordingly, the auditing profession has a strong interest in closely following ongoing developments in this context.

We welcome the fact that, by issuing this DP, EFRAG is making a significant contribution to the debate on the further development of corporate reporting. As EFRAG is well aware, the need to preserve our planet's natural resources in the long term has led to a variety of social and economic policy measures.

Addressing sustainability-related risks is an integral component of companies' business resilience strategies. As the business sector makes a significant contribution to the necessary transformation, there is also a need for information on the economic impacts on individual companies' financial positions in executing this transformation. Although there have been various approaches to corporate sustainability reporting for a long time, it is only in the last decade that the European legislator has enacted binding legislation concerning corporate reporting of sustainability information. This move, however, created a second pillar of reporting alongside financial reporting. There have been various past initiatives directed towards linking these two pillars, most prominently under the term 'integrated reporting'. Indeed, there are numerous interdependencies, which, based on the ESRS, are expressed primarily through 'double materiality' and the requirements to report financial risks and opportunities arising from sustainability phenomena. As both financial and sustainability reporting relate to the same undertaking, the basis for reporting – i.e. basic assumptions – logically have to be the same. The further development of corporate reporting towards greater connectivity between the two pillars is therefore an obvious step. On the one hand, it serves the users of the reporting by improving information efficiency and transparency; on the other hand, it also serves the preparers by providing them with information to foster improvements to their corporate governance. Nevertheless, this further development is subject to **a number of essential conditions which, in our view, are not currently met or require longer-term discussion**.

Financial reporting by European companies has long been based on the relatively stable foundations of the EU Accounting Directive and the IFRS. The necessary processes and practical conventions are therefore largely established. However, this does not apply to sustainability reporting: firstly, this new form of reporting cannot fully rely on the established processes of financial reporting; and secondly, the specific content of sustainability reports (particularly under the ESRS) is still subject to finalization and so has not yet been reliably defined. In this respect, there is a lack of sufficiently long-standing and broad practical application experience, as well as a lack of stakeholder dialogue regarding conventions, best practice, etc. Certainly, many individual companies are well advanced in the development of sustainability reporting and in their dialogue with stakeholders, but a comprehensive and stable picture has yet to emerge. In our view, however, a **stable platform of sustainability reporting requirements and established processes is urgently required before further regulatory measures can be taken**, which may also necessitate (further) intervention in companies' processes. Furthermore, from a European perspective, it will initially be advisable to review the implementation and application of the ESRS in a few years' time by undertaking a 'Post Implementation Review'. This will also allow to see what options companies have identified by then, based on existing possibilities and in consultation with stakeholders, to achieve greater 'connectivity', or indeed what form of connectivity or integration is actually in demand. Such PIR findings would then also make a significant contribution to ensuring a sensible further development of the legal framework. We would also like to point out that, within a globalised economy, only global reporting standards, at least an accepted global baseline, can ultimately be convincing. The further development of the ESRS will therefore also need to be influenced by the ISSB's standards, and vice versa, as recent discussions have shown. The EU is working on a general adoption status of ESRS as equivalent to ISSB standards covering the same topics. Here, too, the process is far from complete. Furthermore, it seems obvious that any development of regulations to enhance the connectivity of financial and sustainability information should be pursued by also considering the ISSB standards.

The Omnibus Initiative has significantly reduced the immediate scope of the CSRD and the application of ESRS and tightened the limitations on the information that can be requested from those companies in supply chains that are not directly subject to the requirements ('value chain cap'). However, it is currently impossible to predict what specific spill-over effects there will be on companies not directly subject to sustainability reporting obligations – particularly SMEs – or how the 'demand' for voluntary reporting standards will develop. For the time being, **it therefore makes sense to await developments in the voluntary sustainability reporting landscape**, as SMEs should, under no circumstances, be burdened by spillover effects of any more extensive (even though in fact only binding on certain companies) connectivity requirements.

This discussion paper establishes connectivity through increased use of cross-references within the various parts of the reporting. With regard to auditing, however, we would like to point out that **stemming from the current legislation the audit of financial reporting and the assurance engagements for sustainability reporting constitute two separate engagements**, for which, respectively a separate audit opinion and assurance conclusion must be issued. According to European requirements, however, these opinions and conclusions do not relate to the same level of assurance, meaning that, for this reason alone, a fundamental separation of the two pillars of reporting is necessary. The further development of European legislation to allow the performance of the financial statement audit together with a reasonable assurance engagement for sustainability reporting, i.e., as one engagement would therefore also foster connectivity. The auditing profession is particularly well-prepared to provide such integrated services.

In light of the considerations outlined above, we believe the European Union is still far away from establishing concrete and binding requirements in European law to establish greater connectivity. Against the background of current geopolitical upheavals, European companies' foremost need is for a period of several years of stability without extensive interference in terms of either reporting content or processes. During this period, the existing regulatory framework can be established and conventions in the form of best-practice solutions can emerge through stakeholder dialogue. On this basis, **consideration can then, at a later date, be given to the further development of the European legal framework**. We therefore view this DP as an important impetus in this debate. The examples provided, in particular, can offer inspiration in this context.

We would be happy to provide further clarification to the extent deemed helpful.

Yours faithfully,

Sack Siegel