Sustainable Finance Advisory Committee for the 20th legislative term of the federal government

Position paper

Tapping the potential of the EU's Corporate Sustainability Reporting Directive

Recommendations for an effective regulatory regime

Working group: Regulatory consistency

February 2025

Working group: Regulatory coherence - CSRD

Lead: Bettina Storck, supported by her colleague Fabian Newger

Aktive Mitarbeitende:

- SFB-members**:** Martina Bentele, Uwe Bergmann, Anja Rivera de al Cruz, Melanie Sack, Antje Schneeweiß, Bettina Storck
- Observers and external support**:** Daniel Kubessa (Siemens Energy), Adrian Schwantes (BdB), Dennis Zagermann (UBA), Kristina Schwedler (DRSC), Silvie Kreibiehl (Germanwatch)

Contents

Overview of recommendations 3

Background and context 4

1. Reduce: targeted demands to facilitate effective application in practice 7

1.1 Reduce the quantity of required datapoints 7

1.2 Shared sector-wide understanding of materiality assessments 8

1.3 Ensure consistency between the scope of consolidation for CSRD and financial reporting, and a focused value chain 10

2. Specify: make requirements specific 12

2.1 Establish planning certainty 12

2.2 Sector-specific standards as needed 13

2.3 Clear and simple rules for transition plans 14

3. Rectify details: further recommendations for improvement 14

3.1 Entity-specific disclosures 14

3.2 Intangible resources 15

3.3 Medium-term and long-term financial materiality 15

3.4 Preparation rather than authorisation in ESEF 16

3.5 Materiality concept: positive impacts vs. mitigation of negative impacts, materiality of information 18

3.6 Classification system for sectors and segments 18

3.7 Inclusion of employee representatives 19

3.8 Coherence with the SFDR 20

Conclusions and outlook 21

Overview of recommendations

Recommendation	Addressed to
Reduce the number of required datapoints, especially for SMEs; focus on quantitative performance indicators with high informational value	European Commission[1]; possibly the German government, auditors and enforcers
Company-specific materiality assessments should be preceded by sector-wide materiality assessments to ensure greater consistency and to reduce costs and administrative burdens	European Commission[1], industry associations, acceptance by auditors
Justifiably limit the purview of reports in terms of the scope of consolidation and the value chain	European Commission[1], acceptance by auditors
Swift adoption of German implementing legislation to ensure planning certainty	German government
Adopt sector-specific requirements as quickly as possible, and only if they have proven to provide added value	European Commission[1]
Clear and simple rules for transition plans, and templates where possible	European Commission[1]
Specific rules on company-specific information that is necessary in exceptional cases	European Commission[1]
Defer requirements to report information on intangible resources until uniform methodology is established	German government; European Commission[1] for fine-tuning
Suspend assessments of medium- and long-term financial materiality until uniform methodology is adopted	Acceptance by auditors; European Commission[1] for fine-tuning
Demand only preparation, rather than authorisation, of documents in ESEF	German government, European Commission[1]
Provide clear definitions for the materiality of information and for distinguishing between (a) positive impacts and (b) the mitigation of negative impacts	European Commission[1]
Segment classification system: harmonise and adapt to international standards	European Commission[1]
Incorporate the CSDDD's due diligence approach (esp. regarding human rights) in the ESRS to improve coherence with SFDR reporting	European Commission[1]

[1] It might be advisable to include additional EU-level bodies and organisations such as EFRAG, the European Parliament and the Council of the EU.

Background and context

The German government's Sustainable Finance Advisory Committee (SFB) is firmly convinced that sustainable finance can play a significant role in helping to solve challenges such as the climate and energy crisis, value chain disruptions, human rights violations and possible related economic downturns.

Transparency is a key prerequisite for the sustainable allocation of capital. It is of critical importance for companies to report relevant, comparable, standardised and reliable information on their sustainability management policies, the services they provide, the adaptation of their business models, and relevant key indicators. This data is the necessary basis that enables investors to make suitable investments in companies and transformation projects.

The adoption of the Corporate Sustainability Reporting Directive (CSRD) and associated European Sustainability Reporting Standards (ESRS) is a key step towards (a) greater transparency and (b) the specification of environmental, social and governance (ESG) standards. The CSRD increases the importance, comparability and quality of sustainability reporting and brings sustainability reporting more into alignment with financial reporting by companies.

The inclusion of sustainability matters in management reporting raises their profile and induces company managers and supervisory boards to take greater responsibility. In addition, by introducing double materiality assessments, the CSRD adds momentum to the development of ESG strategies and provides a systematic framework for reviewing business models, identifying physical and transition-related risks and building resilience.

In particular, by increasing the amount of quantitative information that must be compiled, the CSRD raises the significance of ESG indicators as a management tool and makes it easier for financial institutions and investors to structure their portfolios in a way that facilitates the achievement of ESG goals. For example, the quality and quantity of carbon data provided by companies have improved significantly, and this has positive ramifications.[2] To cite just two examples: First, better data facilitates

---

[2] This also facilitates the internalisation of externalities especially in connection with greenhouse gases, as described in the July 2024 concept paper published (in German only) by the SFB's working group on sustainability accounting.

management strategies that are designed to achieve the net zero targets that many banks and asset managers have set for themselves. Second, information on company locations and supply chains makes it easier for financial institutions to keep track of their region-specific biodiversity and climate risks.

Thus, without a doubt, the Sustainable Finance Advisory Committee welcomes the CSRD's basic approach. The SFB explicitly stated this in an open letter published in October 2022.[3] Corporate governance and capital allocations targeted towards sustainability objectives are impossible without adequate data.

Nevertheless, in the SFB's view, parts of the CSRD show room for improvement. This is not surprising given the CSRD's complexity and scope. Rather, this belongs to the typical iterative process of fine-tuning and improving regulatory mechanisms. Implementing the Directive's rules poses a major challenge for companies. This is due to (a) the sheer quantity of datapoints that must be reported, (b) the detailed information requirements across the entire scope of consolidation and (c) the complexity of the related processes.

At the same time, the CSRD's heavy reliance on a principles-based approach leaves companies uncertain as to whether their implementation will pass required assurance mechanisms. For example, every company must conduct a separate and full materiality assessment; this requires a tremendous amount of work and also impedes comparability. The rules and requirements also leave significant scope for interpretation, which leads to uncertainty in the implementation process.

In addition, companies required to file reports currently have no planning certainty because, at the time of this paper's publication, the CSRD has not yet been transposed into German law. This causes uncertainty regarding the structure of the reports that many companies have been in the process of compiling for about 1.5 years now in order to comply with CSRD rules. The fact that numerous EU members states have already implemented the Directive creates challenges for multinational corporations in particular.

The necessary fine-tuning of the CSRD requires (a) close cooperation between stakeholders, (b) a focus on the Directive's core aims and desired impacts

---

[3] See the SFB's Open Letter on Sustainability Reporting, 31 October 2022.

(particularly as regards the practical relevance and usefulness of the information that must be reported) and (c) the ability to remedy mistakes constructively. The potential improvements identified in this paper therefore focus not only on a revision of the CSRD and ESRS at the EU level (where this legislation aims to establish a level playing field for all European companies) but also on the transposition of the rules in German law and on the auditing of reports.

The forthcoming voluntary publication of the first CSRD-compliant reports in early 2025 will provide a useful opportunity to evaluate the implementation of the new rules in practice. For example, the first reporting cycle will likely provide input that can (a) lead to shared insights on key issues facing specific sectors and (b) facilitate the development of standards for the implementation of transition plans. In any case, the SFB urges any revisions of the CSRD, and of sustainable finance rules in general, to incorporate best practices – for example, in any omnibus legislation[4] that may be adopted.

For all of the above reasons, this position paper's overarching argument is that the CSRD's efficiency, impact and practicability need to be enhanced by:

1. reducing data requirements and complexity
2. adding specificity to existing requirements and
3. making necessary improvements to policy details

These three points provide the basis for this paper's three main sections, as we proceed from general demands to detailed adjustments: from *Reduce* (section 1) to *Specify* (section 2) and finally to *Rectify details* (section 3).

[4] See European Parliament approves new Commission for 2024-2029 (in German only).

1. Reduce: targeted demands to facilitate effective application in practice

1.1 Reduce the quantity of required datapoints

The ESRS require businesses to collect and submit a very high quantity of datapoints. Depending on the findings of materiality assessments, some businesses will have to collect and submit up to 1,000 datapoints for the first time in order to comply with the CSRD. This enormous task poses significant challenges not only for small and medium-sized businesses but also for large companies, because new capacities possessing the requisite skills must be built up and many new processes must be implemented. In general, the initial effort can be accomplished only with external support.

At the same time, it is not always apparent whether these datapoints are relevant for effective governance. Similarly, for users of CSRD reports such as financial institutions, some types of information (e.g. carbon data and location information) are far more relevant for purposes of portfolio management than other types of information (such as metadata, i.e. the additional information that must be reported as part of the very extensive 'minimum disclosure requirements'). The SFB is convinced that a smaller quantity of datapoints would be sufficient for assessing companies' sustainability performance and internal governance.

This can be achieved by adjusting the materiality principle at EU level and applying it in a more focused manner, and by revising the number of required datapoints. The datapoints should be prioritised on the basis of their relevance and their contribution to ESG management and assessment. Prioritising essential data will not only reduce administrative burdens but also improve the quality and informational value of reports. Companies should be put in a position where they can focus on the most important factors and thereby produce more precise and effective reports. Likewise, reporting entities should be given the option to aggregate (sub-)indicators in order to further reduce their workload. The European Financial Reporting Advisory Group (EFRAG) should be tasked with conducting a review to identify dispensable datapoints. This review process should be carried out in close consultation with reporting companies from various sectors.

In order for these improvements to be put into practice, it is also necessary for auditors and enforcers to interpret the ESRS in a pragmatic manner, at least initially. Best practice standards are still lacking in many areas. Accordingly, auditors should use the flexibility at their disposal to the advantage of companies, and enforcers should initially refrain from taking maximal enforcement measures (e.g. by issuing guidance rather than a formal notice of error, for example in cases where the minimum disclosure requirements have not been fulfilled completely).

In addition to these simplifications, tiered data requirements should be introduced in order to reduce the burdens on small and medium-sized companies. The LSME and VSME standards[5] provide a useful approach here (the LSME standard is still in the draft stage and the VSME standard was recently published). The LSME standard's reduced requirements should be adopted as soon as possible and should additionally apply to all large companies of a lesser size (up to 1,000 employees or revenue up to €450 million, equivalent to CSDDD reporting requirements).

In addition, the escalating obligations facing SMEs that are part of larger companies' supply chains must be addressed. Sometimes these SMEs must provide datapoints specified in the ESRS if they are requested to do so by contractual partners who are trying to comply with their own reporting requirements along the value chain. The amount of information that these SMEs have to report should not exceed the reporting requirements set out in the VSME standard. Therefore, in the SFB's view, it is necessary to adopt the planned standards as swiftly as possible in order to provide relief.

1.2 Shared sector-wide understanding of materiality assessments

In addition to a general reduction in the amount of required datapoints, the burdens on companies could be further reduced through sector-wide simplifications of materiality assessments.

Under the CSRD, materiality assessments are currently a sector-agnostic requirement. Accordingly, each company conducts its own materiality assessment without leveraging synergies with other companies in the same sector. This leads to

[5] LSME standard: standard for listed SMEs, which are subject to mandatory sustainability reporting; VSME standard: voluntary standard for non-listed SMEs, which are not subject to mandatory sustainability reporting.

unwanted disparities between materiality assessments within a given sector and increases not only the analytical workload of each individual company but also the workload of auditors and numerous additional stakeholders.

For this reason, the SFB recommends that individual sectors develop their own shared understanding of key issues, along with sector-specific interpretations of questions concerning the ESRS. Taking this approach would mean moving away from a materiality concept which assumes that, for every single "sub-sub-topic" (the term used in the ESRS), materiality results from a company's specific business model or business strategy, rather than assuming that materiality is consistent for most companies within a single sector; this applies to social standards in particular.

For example, AR 16 in ESRS 1 sets out an extensive list of sub-sub-topics that must be assessed individually in terms of materiality. However, many of these sub-sub-topics should be assessed at the sector-wide level. To minimise costs and burdens in this area while simultaneously ensuring the desired consistency, sector-specific materiality assessments could precede company-specific materiality assessments. This would be nothing new: various well-established labour standards (e.g. ILO, CSDDD) apply at the sectoral level, not at the level of individual companies.

Some industry associations (including VDMA, the association of German equipment manufacturers, and ZIV, the German bicycle industry association) have already published proposals geared towards sector-wide materiality assessments. To enhance practicability and relevance, the findings from the first round of CSRD reporting should also be incorporated into this process. This would mean that IROs (impacts, risks and opportunities) typical of specific sectors would not have to be compiled separately by each individual company, and synergies could be leveraged. Conversely, guidelines for sector-wide materiality assessments could help to identify which factors and/or issues are non-material. As long as the relevant companies carry out a plausibility check, auditors and enforcers should accept this practice.[6]

In addition to reducing companies' analytical workload, this practice would have two further advantages: First, it would reduce the number of stakeholder questionnaires

[6] Supervisory authorities are familiar with and require such plausibility checks in conventional forms of financial supervision, e.g. in connection with the use of risk models, ratings of external suppliers/providers, etc.

that form part of the materiality assessment. Currently, many companies have to complete a large quantity of questionnaires from their various stakeholders. At least the questions could be standardised on a sector-wide basis, and in some cases even the datapoints themselves could be made available for the entire sector. Second, it would increase comparability within specific sectors. For example, in the area of decarbonisation management, making data available on a reliable and uniform basis would serve the interest not only of the state but also of stakeholders such as financial institutions that frequently manage their net zero portfolios on a sector-specific basis.

1.3 Ensure consistency between the scope of consolidation for CSRD and financial reporting, and a focused value chain

In order to ensure that the CSRD is effective in practice, it is essential to review the extent to which (a) the value chain and (b) subsidiaries outside the scope of consolidation for accounting purposes need to be included in a company's ESG assessment. Here, the aim must be to review the scope of subsidiaries to be included in the ESG assessment, by taking into account ESG factors that are management-relevant, that can be influenced by the individual enterprise, and that provide sufficient data quality.

One of the great advantages of financial reporting is the use of a uniform unit of assessment: namely a company or corporate group. This enables the consistent assessment of the same unit from various perspectives. The current ESRS rules undercut this unitary approach, because they also require an analysis of the ESG impacts of financially insignificant subsidiaries. This leads, among other things, to distortions in intensity-related indicators, such as carbon emissions relative to revenue or balance sheet totals. Here, the scope of consolidation for CSRD reporting in the numerator is compared with the scope of consolidation for accounting purposes in the denominator, which reduces the informational value of the indicator.

In general, the differences between these two scopes of consolidation are justified, because factors along the entire value chain can have an impact on a company's ESG assessment. In particular, social factors can play a key role precisely at the beginning of the supply chain (for example, during the extraction of raw materials). This is illustrated by the following example: A company owns a cobalt mine in the

Democratic Republic of Congo. Because the mine’s revenue is insignificant in relation to other company subsidiaries, it is not included in the consolidated balance sheet. However, it could be significant in terms of ESG criteria, such as human rights violations.

Yet it is imperative that the parts of the value chain requiring assessment be limited to those where the internalisation of ESG-related factors in products, services and processes delivers the most important findings and the greatest governance impacts. In the example of the cobalt mine, this could justify omitting parts of the supply chain between the extracting subsidiary and the reporting company, and/or parts of the downstream value chain that are non-material in terms of sustainability. In principle, this approach is permitted under ESRS rules. ESRS 1 (64) states as follows: “Paragraph 63 does not require information on each and every actor in the value chain, but only .... in relation to the parts of the value chain for which the matter is material.”

Omissions along the value chain can be justified for two reasons: first, when the cost-benefit ratio of collecting the data declines as the distance from the reporting company increases along the value chain; and second, when data quality declines significantly as the distance increases along the value chain. The direct collection of primary data is often difficult or impossible in practice, especially when the reporting company has a large number of suppliers, when value chains are long and complex, or when the data is being collected as part of a financial institution’s portfolio management.

As a result, many reporting entities resort to estimates and/or external secondary data. For this purpose, the European Commission and EFRAG should support pragmatic estimation methods. Such methods already exist in many cases, and they could be applied uniformly for all relevant companies while also being accepted by auditors. This would enhance both efficiency and report quality. Moreover, this approach has already been proposed as part of the draft LSME Standard (Chapter 4.2: Estimation using sector averages and proxies) in order to ease the burden on small and medium-sized businesses.

2. Specify: make requirements specific

2.1 Establish planning certainty

Current planning uncertainty regarding the correct way to interpret the CSRD poses a substantial risk for companies. The highest priority here must be to transpose the CSRD into applicable German law in order to eliminate the uncertainties facing reporting companies and establish a level playing field throughout the EU. We urge German lawmakers to complete this process as quickly as possible while simultaneously taking into consideration the criticisms raised by various stakeholders.

Currently, the resources that companies must expend in order to establish processes and compile reports are unnecessarily high, because companies are forced to carry out time-consuming internal and external consultations in order to arrive at a well-informed "best guess" regarding the interpretation of the CSRD or to review already-prepared CSRD reports in terms of their compliance with the NFRD. Until Germany's implementing legislation is enacted, companies will continue to face the risk that they will have to overhaul their processes due to incorrect interpretations of the CSRD, which in turn will lead to additional costs and a higher workload.

Planning certainty can be strengthened in various ways. One way would be for the European Commission or national authorities to publish detailed and binding guidelines that establish clarity regarding the interpretation of the CSRD. These guidelines should be easy to understand and workable in practice. To facilitate compliance with the CSRD, additional measures could include (a) the introduction of straightforward procedures to clarify questions of interpretation and (b) support and training for companies.

Auditors can contribute to this process by providing clearly stated opinions and comments. For example, a publication by the Institut der Wirtschaftsprüfer (Institute of Public Auditors)[7] provided timely assistance regarding the question of whether reports prepared in compliance with the ESRS also meet the requirements of the NFRD Implementing Act, which continues to apply.

---

[7] IDW 2024, IDW sieht Rechtsunsicherheit durch verzögerte CSRD-Umsetzung ("Delayed implementation of the CSRD gives rise to legal uncertainty", in German only).

2.2 Sector-specific standards as needed

Sector-specific requirements were initially planned with the right approach: namely, to address the particular challenges, technological possibilities and regulatory requirements of specific sectors. However, they are now coming at a point in time that is simply too late. The first companies preparing reports in line with the CSRD have largely completed their reports for 2024. Many other companies have already established all of their processes for 2025 and started them to some extent.

For this reason, the SFB takes the position that sector-specific standards should be adopted only on an as-needed basis and should have a completely different focus than current proposals. After the initial CSRD reports are published, EFRAG should carry out an evaluation of the use of the sector-agnostic ESRS. The priority here should be to identify informational gaps that are relevant for governance purposes. This evaluation could take place by 2026 at the latest, as part of the legally stipulated review of the ESRS pursuant to Article 29b(1) of the EU Accounting Directive. Sector-specific standards should be considered only if the evaluation's findings show that information is lacking which is necessary for the sustainable management of companies and portfolios. This will ensure that the formulation of sector-specific standards would be based on genuine need, thereby avoiding unnecessary reporting requirements.

Furthermore, any sector-specific standards that are adopted should be kept as clear and simple as possible and restricted to a small quantity of relevant datapoints. Additional datapoints that go beyond the sector-agnostic ones might make sense on a case-by-case basis, but not in the high quantity envisaged in the initial proposals.[8] Beyond these, nothing other than sector-wide guidelines for materiality assessments – if any have been adopted – and sector-specific interpretations of key questions (as described in section 1.2 above) should be included. Focusing on rules that are clear and applicable in practice will facilitate a balance between (a) sector-specific characteristics and (b) the general comparability of reports.

[8] See e.g. EFRAG's ESRS Oil and Gas Exposure Draft, published in September 2024.

2.3 Clear and simple rules for transition plans

Requirements for transition plans should be formulated clearly and simply in order to ensure comparability and minimise the workload involved. Interoperability with other disclosure requirements relating to transitions, such as banking supervision requirements, should be ensured.

Uniform, sector-wide templates for transition plans could provide valuable assistance in achieving these goals. A priority should be placed on ensuring that requirements are formulated in an open-ended way in order to enable companies to report realistic information regarding transition strategies, impacts and timelines.

A more in-depth analysis of transition plans will not be provided here, since the SFB's working group on transition plans is publishing its own comments on this subject.

3. Rectify details: further recommendations for improvement

3.1 Entity-specific disclosures

ESRS 1 paragraph 11 stipulates that companies must provide additional entity-specific disclosures (ESDs) in their reports. However, the ESDs are formulated vaguely and lead to divergent interpretations, not to a fair and comparable description of impacts. ESDs can include (among other things):

a) figures that are reported for other frameworks such as GRI
b) figures for ESG ratings
c) corporate governance metrics that are not defined in the ESRS

These divergent interpretations undermine the objective of uniform and comparable sustainability reporting. A survey by the Deutsches Rechnungslegungs Standards Committee (the Accounting Standards Committee of Germany)[9] confirmed the uncertainty surrounding the ESDs: the DAX 40 companies interpret them very differently. It is striking that 11 of these companies report zero ESDs, 17 report up to

[9] DRSC 2024, Kurzumfrage zum Stand der Wesentlichkeitsanalyse in den DAX40-Unternehmen (Survey on the current status of materiality assessments at DAX 40 companies, in German only)

two, and very few report more than three. Neither the recently published responses by EFRAG nor the updated Q&A platform provide specific clarifying information.

In order to maximise comparability and limit reporting burdens, the EU needs to provide clear definitions of the exceptional conditions under which ESDs must be reported. Any key figures that go beyond this should be voluntary and not be included in the minimum disclosure requirements. Moreover, any figures that are relevant for an entire sector and that are not included in ESRS 1 (such as cybersecurity) should be included in sector-specific standards and not in ESDs that relate only to individual companies. We emphasise once again that sector-specific standards should be adopted only on an as-needed basis and that only a very limited number of figures should be added to ESRS 1 (see section 2.2 above).

3.2 Intangible resources

Germany's draft implementing legislation requires a description of the intangible resources that are most important for purposes of value creation. These include human capital, intellectual capital, trademarks and other intangible resources. For decades, various entities have been working to develop methods for assessing intangible resources, but no standard has been established to date.

Information on intangible resources that is subject to reasonable assurance must be provided in the general section of management reports. In terms of sustainability reports, however, this requirement will cause companies a tremendous amount of work as long as no practical methodology has been established and will also lack assurance. For this reason, reporting on intangible resources should be deferred until a uniform methodology has been adopted.

3.3 Medium-term and long-term financial materiality

The methods for determining the financial effects of material risks and opportunities currently lack sufficient specificity. ESRS 2 SBM-3 requires general information on the anticipated effects of a company's material risks and opportunities on its financial position, financial performance and cash flows over the short, medium and long term, including the reasonably expected time horizons for these effects. However, specific rules defining how these reporting requirements are to be put into practice are lacking.

The environmental standards contain expanded requirements for assessing the long-term financial effects of environmental measures. However, apart from the (insufficient) specifications relating to climate change (ESRS E1), no clear rules are set out. This means that companies must grapple with considerable uncertainty in terms of methodology and implementation.

EFRAG addresses these challenges by providing for a phase-in period: reporting entities are not required to submit information during the first reporting year and must submit only qualitative information in the second and third reporting years. But this merely pushes the problem into the future rather than solving it. Without predefined methods, it will be very difficult to fulfil the criterion of comparability.

Therefore, the requirements in question should be suspended until generally accepted and workable rules have been adopted. This would be consistent with the approach to sector-specific information, which does not have to be supplied until corresponding delegated legislation has been adopted. A specific, uniform methodology for assessing long-term financial materiality is necessary in order to ensure the comparability and informational value of reports.

3.4 Preparation rather than authorisation in ESEF

Germany's draft CSRD implementing legislation stipulates that CSRD reports must be authorised using the European Single Electronic Format (ESEF), in the form of XBRL files. This format imposes complex technical specifications that generate a significant amount of extra work for most companies. Furthermore, ESEF offers only minor advantages for readers and can even have disadvantages, such as programme-based display inconsistencies.

This draft rule stands in contrast to the original directive, as well as the provision set out in section 328 of Germany's Commercial Code (*Handelsgesetzbuch*). The original wording of the CSRD, "to prepare", has mistakenly been translated as "aufstellen", which means "to authorise" instead.[10] Under the Commercial Code, documents only have to be prepared and published (*offengelegt* in German) using ESEF. The authorisation of documents, however, can occur in any established digital format (such as PDF). Moreover, ESEF's advantages are fading as the use of

---

[10] In line with IAS 10 and 17 and Regulation (EC) No 1606/2002.

artificial intelligence (AI) grows. Many investors are already using AI to extract information from sustainability reports without having to rely on ESEF's tagging feature.

The SFB holds the view that permitting companies to authorise their sustainability reports in an established format of their choice, and then requiring them only to publish the reports in ESEF, would be in compliance with the CSRD and would be much less complicated and costly. Furthermore, authorising the report in established formats would mean that the ESEF file would not be the legally binding document.

Refraining from requiring the authorisation in ESEF would have the additional advantage that references could be made to other reports and publications that are not available in ESEF. This would help to prevent redundancies and duplicate reporting. Many ESRS provisions – in particular, those pertaining to governance under ESRS 2 – require the reporting of information that already has to be disclosed in annual reports. To help avoid duplicate reporting, ESRS 1 permits cross-references in the form of "incorporation by reference" (paragraph 119 et seqq.). However, this option is undermined by a provision stipulating that such references can be made only to information in documents that meet the same digitalisation requirements as the sustainability statement.

Germany's CSRD implementing legislation should therefore require only the preparation of sustainability reports in ESEF. Furthermore, efforts should be undertaken at the EU level to remove electronic formatting requirements altogether from sustainability reporting legislation. This applies in particular to ESRS 2 governance requirements that could be limited, at the very least, to quantitative disclosures that could then be supplemented with references to other company documents. Having such options to make references to other documents will help to avoid duplicate disclosures while also increasing the informational value of sustainability reports. It is important to ensure that referenced documents are subject to the proper level of assurance – reference should of course not be made to documents with insufficient or no assurance.

3.5 Materiality concept: positive impacts vs. mitigation of negative impacts, materiality of information

One key problem in connection with materiality assessments is the difficulty in distinguishing between (a) positive impacts and (b) the mitigation of negative impacts. This can be illustrated with the following example: A company in Denmark reports that all of its impacts relating to ESRS S1 are positive, while companies in Germany develop the practice of classifying these same outcomes as the mitigation of actual or potential negative impacts. These types of divergent assessments should be avoided.

Moreover, the concept of materiality of information (as used in ESRS 1 34(b)) needs to be defined more clearly. This concept is used in reference to cases where an ESG factor or subtopic is assessed to be material, but individual related datapoints provide no relevant information. In practice, this concept remains poorly understood and is interpreted restrictively, which leads to further discrepancies in reporting. In a July 2024 report[11], EFRAG stated that “40% of undertakings leverage the Information Materiality, a concept that does not yet seem to be well understood by the participants of the study.”

EFRAG’s current materiality assessment implementation guidance (IG 1) should be thoroughly revised and made more specific in order to ensure uniform application. There must be clear definitions for when a company’s activities are to be classified as the mitigation of negative impacts, and when they are to be classified as positive impacts. In addition, a more precise definition for the materiality of information (as used in ESRS 1 34(b)) is needed in order to ensure that the concept can be understood and applied in practice. This will facilitate consistent and comparable reporting by companies.

3.6 Classification system for sectors and segments

Under the EU’s sustainability reporting rules, the sectoral classification system of the ESRS is to be harmonised with the the EU’s NACE codes. However, this system diverges significantly from well-established systems at the international level such as

[11] EFRAG 2024, Implementation of ESRS: Initial Observed Practices from Selected Companies.

GICS and SICS, which are used in the SASB standards and feed into the ISSB standards. This reduces comparability, impedes interoperability with other international frameworks, and increases the workload for companies that have to adapt their reporting systems.

The lack of connectivity with the financial statements of diversified companies poses an additional challenge. While IFRS segment reporting uses typical segment classifications, the ESRS sectoral system often requires a reclassification of segments based on NACE codes. This means that companies have to implement additional systems and processes in order to comply with divergent requirements, which is extremely time-consuming and costly.

For this reason, the ESRS classification system should be harmonised with generally accepted international standards. This would improve interoperability with other frameworks and reduce the costs and workload for companies. In addition, harmonising ESRS sectoral classifications with existing international systems would enhance both the comparability and informational value of sustainability reports. It is also advisable for segment classifications in the EU's sustainability reporting system to remain closely aligned with financial reporting in accordance with IFRS 8, in order to ensure consistent and coherent descriptions of business activities.

3.7 Inclusion of employee representatives

The involvement of employee representatives outside of Germany, as envisaged by the potential inclusion of European Works Councils as set out in the German government's draft implementing legislation, would (a) generate significant additional organisational work for companies and (b) diverge from standard financial reporting practices. In standard financial reporting practices, the involvement of employee representatives – which the SFB considers indisputably necessary – takes the form of representation by employee representatives on the supervisory board.

The SFB considers this practice to be appropriate, also in the context of non-financial reporting, and recommends that the draft implementing legislation be formulated accordingly and with greater precision. The legislation should state clearly that the inclusion of European Works Councils is optional, in order to avoid unreasonable extra work for companies.

3.8 Coherence with the SFDR

Financial market participants need information from CSRD reports in order to file their own reports in accordance with the Sustainable Finance Disclosure Regulation (SFDR). The SFDR stipulates that financial market participants with over 500 employees must file annual statements on the principal adverse impacts (PAI) of all their investments.

The connections between (a) the CSRD's ESRS and (b) PAI statements that must be filed in accordance with the SFDR are set out in a list compiled by EFRAG that shows which CSRD datapoints are relevant for purposes of SFDR reporting[12]. However, there are open questions in this regard that are discussed in a separate SFB position paper focusing on the revision of the SFDR.

Looking specifically at the CSRD, however, human rights due diligence information reported in accordance with the ESRS should be made more useful for purposes of reporting on PAI 10 and 11. There are twelve items in the ESRS that require information on the human rights due diligence carried out by companies. Each of these items contains two to 16 datapoints. Depending on the outcome of the materiality assessment, this amounts to a total of approximately 100 datapoints. From these datapoints, one value each for PAI 10 and 11 must be extrapolated. This leaves significant scope for varying interpretations, which in turn generates uncertainty for companies and investors. This lends further support to our recommendation that the datapoints specified in the ESRS should be reduced to those that provide the greatest informational value.

We recommend that the datapoints on the implementation of human rights due diligence be pooled in accordance with Articles 7 to 14 of the Corporate Sustainability Due Diligence Directive (CSDDD). The CSDDD provides for the implementation of a risk analysis at the outset of the due diligence procedure, in order to identify stakeholder groups and relevant topics. This means that it should no longer be necessary to survey different stakeholder groups separately and report varying datapoints. The CSDDD also takes full account of the UN Guiding Principles on Business and Human Rights.

[12] EFRAG 2023, Draft IG 3 List of ESRS Data Points

Overall, this would make the information reported under the ESRS more useful for purposes of SFDR reporting. It would also increase uniformity within the entire European sustainable finance framework, because the recommended approach would be consistent with the CSDDD and the EU Taxonomy.

Conclusions and outlook

Our recommendations for the CSRD – to reduce its scope, add specificity and rectify details – aim to make the Directive more workable and effective in practice. This can enhance the quality of reporting while simultaneously reducing the challenges that companies are confronted with. The detailed nature of our arguments is intentional; our aim here is to ensure that our recommendations are precise, understandable and workable in practice.

Right now, the top priority is to transpose the CSRD into German law. At the same time, the necessary improvements to the Directive need to be undertaken as quickly as possible at EU level. The resulting increase in consistency between the CSRD, the SFDR, the CSDDD, the Taxonomy Regulation and the ISSB standards will be of vital importance.

The need to build sustainable economies is intensifying. At the same time, ESG priorities are coming under increasing pressure in the current political and social climate. By improving the CSRD, we will send out a clear message affirming the opportunities that ESG frameworks present. By taking into account the complex challenges that companies are facing and by providing clear and practical rules to support them in this effort, the revisions recommended in this paper can help shift the legislative focus back to the great potential and original purpose of the CSRD.