

FIVE POINTS ON THE EUROPEAN SUSTAINABILITY REPORTING STANDARDS

13 JANUARY 2023

DANISH INSTITUTE FOR HUMAN RIGHTS REACTION TO EFRAG SET 1 EUROPEAN SUSTAINABILITY REPORTING STANDARDS

The Danish Institute for Human Rights (the Institute) welcomes the publication of the final version of the [first set of European Sustainability Reporting Standards](#) (ESRS) under the [Corporate Sustainability Reporting Directive](#) (CSRD). The Institute has been engaging actively with the EU process of updating the sustainability reporting standards. This includes [inputting](#) to the consultation on the revision of the CSRD in November 2021 as well as [inputting](#) to the draft ESRS during the consultation in August 2022. The Institute has also done work in its own capacity related to corporate reporting and human rights. Examples include [a paper](#) on big data analysis of sustainability reporting and human rights as well as a country snapshot of Danish companies' reporting on human rights in [2020](#) and [2022](#).

Based on this expertise, the Institute wishes to highlight five key points ahead of the adoption by European Commission of delegated technical standards on sustainability reporting expected in summer 2023.

1. Logic and coherence of the ESRS

The Institute welcomes the overall architecture of the ESRS which present a clear and logical starting point for ensuring comprehensive sustainability reporting.

One of the key innovations of the ESRS is its implementation of the double materiality approach, which will be key to ensuring that future reports adequately reflect risks to people and planet alongside risks to the undertaking.

Meaningful implementation of due diligence enables preparers to identify impacts that are material from an impact materiality perspective. In this regard, the Institute welcomes clarification of the link between the identification phase of due diligence and the assessment of impact materiality through the specific reference to the process of due diligence in the UN Guiding Principles on Business and

Human Rights (UNGPs) and OECD Guidelines for Multinational Enterprises (OECD GL) in ESRS 1 paragraph 48.

The Institute also welcomes a number of other clarifications in the adopted draft. In the Institute's submission to the exposure drafts, a number of recommendations were made to clarify the concepts in the ESRS, for example:

- With respect to the concepts of relevance and impact materiality interrelate, we are pleased to see that adjustments have been made to make these clarifications in Appendix C of ESRS 1;
- With respect to the recommendation that extraneous concepts like information materiality be removed, we are pleased to see that this has been addressed;
- with respect to the element of faithful representation, we are pleased to see that the suggested clarifications around the concept of neutrality to ensure that information should not be netted to be compensated or neutral have been made in the ESRS Appendix C QC 8.

We are comforted by the fact that recommendations which have the aim of providing greater clarity and better aligning with the key international frameworks such as the UNGPs and OECD GLs have been actioned by EFRAG in the revision of the final drafts of the ESRS and encourage the Commission to retain this conceptual clarity based on expert advice.

However, there remain a number of points which would benefit from greater clarity outlined below.

2. Alignment with the key international frameworks: the UNGPs and OECD GL

The final draft ESRS refer and commit to alignment with the due diligence approach informed by the UNGPs and OECD GL, which is very welcome. In particular, the Institute welcomes other clarifications in the revised drafts which ensure better alignment with the UNGPs and OECD GLs, for example, clarification that the concept of significance should be interpreted in line with these key frameworks in ESRS1 paragraph 44.

However, there are a number of examples of deviations from the approach in those frameworks that risk confusing preparers and diluting the approach. For example OECD GL and UNGPs make use of

both risks and impacts in the context of sustainability, but the ESRS uses impacts only when referring to impact materiality and risks when referring to financial materiality aspect.

Further, we have previously made calls to better align the five steps included in the social standards with the due diligence steps of the UNGPs and OECD GLs, but room for improvement remains. While ESRS 1 paragraph 65 provides welcome clarification on where the stages of due diligence are situated in the ESRS, as noted in our previous submission, these stages of due diligence are situated at different levels within the architecture of the ESRS: ie the identification phase is considered only in ESRS 2 IRO and SBM 3, whereas the subsequent four stages, taking action to address impacts, tracking implementation and results and remedy is addressed primarily in the implementation disclosures forming part of the topical standards. We remain of the view that a description of the process for and outcome of the impact materiality assessment is relevant not only at the cross-cutting level of ESRS 2, but also at the level of the topical standards.

3. Cross-topical reporting

As noted in our previous submission, whilst the division in topical standards is intuitive and clear, it comes with the risk of driving siloed approaches to integrated sustainability matters. It is not entirely clear how preparers are encouraged to reflect on and disclose the interrelations between the E, S and G impacts. Specifically from a human rights perspective, environmental, climate, tax or corruption impacts all could be associated with human rights impacts. We repeat our recommendation that the ESRS more clearly incentivise preparers to consider and disclose information around cross-topical aspects of their material sustainability impacts.

4. Social key performance indicators

As noted in our previous submission, the Institute welcomes the inclusion of performance measures in ESRS S1 and recommends that ESRS S2-S4 are developed further to also include relevant performance measures, where possible. We again acknowledge the difficulty inherent in developing cross-cutting performance measures for all the social topical standards, particularly S3 and S4, and remain of the view that to a large extent it is appropriate to deal with these in sector standards. However as noted previously, there are some cross cutting KPIs which we believe are relevant to all categories of stakeholder, for

example ESRS S1-17 which considers identified cases of severe human rights issues and incidents (although as previously noted we have a few comments on how to further improve that DR, such as that it focus not only on numbers but also contains qualitative descriptions). Further, we are of the view that a number of the performance indicators in ESRS S1 could be carried over to ESRS S2, acknowledging that there may be challenges in gathering data in relation to workers in the value chain.

In addition, although it is acknowledged that KPIs will be further developed in the coming sectoral standards, the ambition of the ESRS should be to broaden the range of sector agnostic KPIs over time including the development of indicators touching on a broader range of rights beyond labour rights.

5. Policy coherence

It is unclear how the disclosure needs of the forthcoming Corporate Sustainability Due Diligence Directive (CSDD) will be reflected in the ESRS. While the development of the CSDD is at a much earlier stage of the legislative process, it is nonetheless anticipated that the disclosures required under the CSRD will be closely linked to the due diligence obligations under the CSDD. Accordingly, the Institute encourages alignment to the greatest extent possible between these two parallel measures.

Further, there are key features of the ESRS which should be maintained as they are ultimately adopted in a delegated act. For example, consistent with the Commission's proposal for the CSDD, it is extremely positive that the ESRS require reporting undertakings to consider the full value chain, including the downstream, when assessing impact materiality. Taking such an approach will help to ensure that critical impacts are not overlooked, particularly for companies whose most severe risks occur in the downstream part of the value chain, such as those in the tech sector.