Consultation response from the Ecological Accounting Chair – Delegated Act on European Sustainability Reporting Standards (set 1)

On June 9th, the European Commission (hereinafter, **Commission**) launched a public consultation on the first set of European Sustainability Reporting Standards (ESRS), which are to be adopted shortly by means of a delegated act. The following letter provides general comments from the Ecological Accounting Chair[1] (**EAC**) in relation to this consultation.

The EAC is witness to concerns, expressed by a diverse range of stakeholders, that recent amendments proposed by the Commission may contradict the ambition set out by EFRAG. Indeed, in its commitment to alleviating the reporting burden, the Commission has substantially reduced requirements contained in ESRS set 1, and it is unclear to what extent the quality and comparability of information provided in firms' sustainability reports may be jeopardised as a result of these changes.

To ease these concerns, it would seem helpful to provide stakeholders with detailed justifications in support of each amendment proposed, and the current consultation process may have to be adjusted accordingly (see 1. Due process). This would provide better conditions to discuss important aspects of ESRS set 1 and propose relevant improvements where necessary. In this regard, the EAC has identified gaps in the definitions of materiality that have not been fully addressed by the Commission's amendments, and we estimate that inconsistencies in the process of materiality assessment may arise as a consequence (see 2. Materiality).

We also raise several issues concerning ESRS conceptual framework, in relation to areas of controversy within the accounting research arena (ses 3. Future accounting developments).

A table synthesising our propositions is provided at the end of this letter (see Appendix 1).

1. Due process

It is difficult to assess how opinions recently raised by European Supervisory Authorities (ESA) have been taken into account in amendments proposed by the Commission. The delegated act gives only a broad outline of these amendments, and justifications are equally imprecise. Consequently, stakeholders may lack sufficient information to form a belief and provide in-depth feedback.

The CSRD requires the Commission to request the written opinions of ESA before enacting delegated acts on ESRS. [2] On January 26th, ESA answered the Commission's request for opinion on ESRS set 1, and expressed overall support for EFRAG's proposed standards.

[1] The EAC is a French partnership research chair created in 2019, aimed at developing, promoting, and experimenting strong sustainability accounting frameworks. Our academic partners are AgroParisTech (French Institute of Technology for Life, Food and Environmental Sciences), Université Paris-Dauphine, Université de Reims Champagne-Ardenne and Institut Louis Bachelier. Our sponsoring partners are Ministère de la Transition Écologique, Agglomération Cœur d'Essonne, Conseil National de l'Ordre des Experts-Comptables, CDC Biodiversité, CDC Recherche, LVMH, Groupe Rocher, Port Atlantique La Rochelle, Crédit Mutuel Arkéa, cabinet Vertigo Lab, cabinet Dame A La Licorne and cabinet AScA. To consult our website: https://www.chaire-comptabilite-ecologique.fr/

[2] Rules of due process to which the Commission is legally committed are set out in article 49(b) of the Accounting Directive, as modified by the CSRD.

However, ESA also highlighted possible inconsistencies and proposed improvements in relation to their respective areas of expertise. To illustrate, we report below a selection of comments and suggestions raised by the European Securities and Markets Authority (**ESMA**) in its official reply:[3]

- The disclosure of climate-related information according to ESRS E1 and the disclosure of metrics needed by financial market participants should remain mandatory to ensure cohesiveness with EU financial legislation;[4]
- Thresholds setting different regimes of compliance between firms should not be set arbitrarily, and should be avoided as much as possible to avoid gaps in comparability;[5]
- Too long phase-in periods should be avoided as financial market participants and other stakeholders need quality information on sustainability matters here and now;[6]
- Supplementary guidance (e.g. in the form of new application requirements) is needed to increase cohesiveness in undertaking's materiality assessments, especially regarding the topical factors to be considered and the criteria used to set materiality thresholds;[7]
- It could be useful to disaggregate disclosure requirements currently applying to both impacts and risks (e.g. ESRS 2 SBM-3, MDR-P, MDR-A) to improve ESRS interoperability with GRI (regarding impact disclosures) and ISSB (regarding risks disclosures).[8]

Overall, although some items reported in the list above were aiming later phases of the standard-setting process,[9] and although some technical improvements not mentioned in this list were indeed taken into account by the Commission, we note that amendments proposed in the draft delegated act are often leaning in a direction opposite to what ESMA suggested was the desirable path for future improvements - and the same observation would apply to opinions raised by the European Banking Authority (**EBA**) and the European Insurance and Occupational Pension Authority (**EIOPA**). Indeed, concerns raised by ESMA (resp. EBA and EIOPA) regarding (1) materiality assessment, (2) integration within other EU legislation, and (3) phase-in periods (see comments below) have now become more relevant than before as multiple amendments have been decided on to streamline reporting requirements.

Firstly, references to application requirements have disappeared from the table in ESRS 2 Appendix C (formerly Appendix D) "Disclosure *and Application Requirements* in Topical ESRS that are applicable in conjunction with ESRS 2 General disclosures", which makes one wonder whether these application requirements have implicitly become voluntary. Moreover, while requirements related to ESRS 2 IRO-1 are applicable irrespective of the outcome of the materiality assessment (as stated in ESRS 2 par 2), the question now arises as to whether a distinction is being made between *disclosure* requirements (paragraphs related to ESRS 2 IRO-1[10] included in the *main body* of topical ESRS) and *application* requirements (paragraphs related to ESRS 2 IRO-1 included in the *appendices* of topical ESRS). If the latter

[3] ESMA, *Opinion of the European Securities and Markets Authority of 26 January 2023 on the technical advice by the European Financial Reporting Advisory Group on European Sustainability Reporting Standards (Set 1)*
[4] Ibid, par 43
[5] Ibid, par 44
[6] Ibid, par 51
[7] Ibid, par 47 & 67
[8] Ibid, par 96 & 97
[9] Ibid. Comments by ESMA regarding improved guidance on materiality assessment and better interoperability with ISSB and GRI were aimed to be considered by the Commission "as soon as possible [after adoption of set 1] and ideally before adopting set 2". Other comments alluded to in this letter were aimed to be accounted for prior to the adoption of set 1, which means right now.
[10] We take this opportunity to signal that paragraphs quoted in ESRS 2 Appendix D in reference to climate-related disclosure requirements linked to ESRS 2 IRO-1 (last row, right column of the table showed in Annex 1, page 68) should be paragraphs 20 to 21 rather than 16 to 17 ; if this mistake was not corrected, undertakings would no longer be required to assess their GHG emissions and to distinguish between physical and transition risks when performing their climate-related materiality assessment, which would evidently impair the credibility of reporting.

were no longer applicable irrespective of the outcome of the materiality assessment, as implied by their having been removed from ESRS 2 Appendix C, the common pool of factors to be taken into account when performing such an assessment would shrink and comparability between firms' sustainability reports could be impaired. This would seem contradictory to what ESMA pleaded in its reply when asking for more application requirements and more guidance on the process of materiality assessment.

Secondly, regarding integration within other EU legislation, irrespective of their size or the magnitude of their impacts, firms can now bypass requirements contained in ESRS E1 and ESRS S1 (S1-1 to SI-9) if they consider underlying sustainability matters to be immaterial. They can also omit to report metrics related to EU financial legislation, without providing any justification.[11] These modifications clearly run counter to ESMA's advice regarding the integration of ESRS within other EU legislation..

Thirdly, new phase-in periods have been granted, particularly to smaller companies. Among other things, undertakings with less than 750 employees may now omit scope 3 GHG emission data in the first year that they apply the standards. Yet, GHG emissions, particularly scope 3 GHG emissions, do not depend on the number of people directly employed by a firm. On this matter as well as on other matters where the granting of phase-in periods has been subjected to the 750 employee-threshold, (e.g. biodiversity), it is not always understandable why such a specific threshold has been chosen and how it relates to science-based conservation goals. Be it as it may, these new phase-in periods and this new reporting threshold certainly contradict ESMA's view that, as much as possible, information on sustainability matters should be provided here and now, and thresholds setting different regimes of compliance should be avoided to the greatest extent possible.

Besides, the delegated act brings to our knowledge the fact that, in addition to collecting ESAs' advice, "the Commission services held meetings with a number of stakeholders to hear their views on the draft standards, and some stakeholders spontaneously submitted comments in writings".

Whether, in the general case, such private meetings and submissions can politically take precedence over official opinions raised by public authorities is a matter of debate that goes beyond the scope of this letter, although in the present occurrence, given that standard-setting around ESRS is highly disputed, it is our view that public authorities giving their opinion based on official mandates should be given particular consideration. It is indeed surprising that the Commission based so many of its decisions on undisclosed interactions with stakeholders, and backed these decisions with a cost-benefit analysis whose methodology the public has not been informed of, while EFRAG had already addressed both of these concerns (stakeholder interaction and cost-benefit analysis) in a transparent way along the course of its mandate.[12]

As mentioned in several provisions of the CSRD, transparency is paramount to achieving high-quality standard-setting.[13] Thus, private consultations with stakeholders, however legitimate or necessary they may be in final stages of negotiations, should not in any case prejudice other stakeholder's ability to monitor policy making in full knowledge of facts.

[11] ESRS 1 paragraph 36 states: "when reporting on metrics and when disclosing the datapoints that derive from other EU legislation listed in Appendix B of ESRS 2, if the undertaking omits information prescribed by either a Disclosure Requirement or a datapoint of a Disclosure Requirement in the Metrics and Targets section of a topical ESRS, such information is considered to be implicitly reported as not material for the undertaking".

[12] EFRAG's obligations are detailed in article 49 par 3b of the Accounting Directive, as modified by the CSRD. On the whole, observers acknowledged that EFRAG respected these obligations, in particular those concerning stakeholder interaction and due process.

[13] According to recitals 39 and 40 of Directive 2022/2464, transparency requirements should apply equally to EFRAG and to the Commission in their respective duties.

To avoid any problem related to stakeholders' involvement in the due process, it would have seemed logical that draft standards proposed by EFRAG in November were submitted to stakeholders' opinions right away by the Commission, as part of an extended public consultation. In this way, the Commission would have given every stakeholder an equal chance to influence its decision making, and yet another consultation (as the one we are currently responding to) would not have been necessary to ensure transparency of the whole process. Instead, the choice has been made to disclose amendments all at once and to launch a shortened consultation which put most stakeholders somewhat before the *fait accompli*.

It would be helpful if the Commission could disclose an official document listing every amendment it has made to the draft standards submitted by EFRAG in November, accompanied with a basis for conclusions detailing how ESAs' and other stakeholders' opinions were taken into account.

(Proposition 1)

To grant time for duly motivated feedback to arise, it may also be helpful to delay the deadline of the present consultation for another two weeks (and ideally more).

2. Materiality

Along the standard-setting process, controversies have arisen as to how the concept of materiality should be defined in ESRS and what consequences it should produce. Failure to answer these questions with sufficient clarity can only lead to further confusion and a lack of cohesiveness in how firms will comply with the CSRD.

As discussed in the delegated act, many stakeholders drew the Commission's attention to "the need for additional guidance [...] in particular but not only with regard to the materiality assessment". Indeed, many respondents to the present consultation have already criticised the current draft ESRS for granting too much discretionary power to undertakings with regard to the materiality assessment, and warn that a lack of guidance on this subject could undermine cohesiveness and comparability. This risk could be heightened by the fact that, under new amendments proposed by the Commission, all disclosure requirements (except those in ESRS 2) are now subject to the materiality assessment. This situation calls for a rapid clarification.[14]

On the conceptual side, materiality is an accounting principle stating that all transactions (whether financial or, in the broadest sense, also ecological) susceptible to significantly influence decision-making by key stakeholders should be accounted for using the legally binding principles and rules set out in accounting standards.[15] This means that such legally binding principles and rules may be exceptionally bypassed when reporting a transaction if this does not impair stakeholders' ability to base their decisions on complete, reliable and truthful information.

[14] Although future guidance on materiality assessment will indeed be necessary in the longer run, especially regarding the thorny issue of materiality thresholds – and the EAC stands ready to help in this work –, propositions 2a, 2b and 2c (see below) are meant to be taken into account right away.

[15] In the context of US financial accounting, Harvard Business School defines materiality on its website as "an accounting principle which states that all items that are reasonably likely to impact investors' decision-making must be recorded or reported in detail in a business's financial statements using GAAP standards." (Source : https://online.hbs.edu/blog/post/what-is-materiality). This definition focuses on investors, and should be extended to other key stakeholders, both internal and external, when considering double materiality.

This definition actually contains two distinctive elements : a principal element, which is the necessary condition for information to be material, and a secondary element, which is the possible consequence of information being non-material/"immaterial". The necessary condition for a transaction to be considered material is its expected relevance from the standpoint of at least one group of key stakeholders when they take decisions on the basis of financial accounts and/or accounting disclosures. The possible consequence of a transaction being immaterial is the possibility to apply simpler methods and/or to bypass certain principles when reporting on this transaction in financial accounts and/or accounting disclosures.[16]

In the context of sustainability reporting, the definition of financial materiality given in ESRS 1 has been brought into line with ISSB's definition, and it currently states that "information is considered material for primary users of general-purpose financial reporting if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the undertaking's sustainability statement".[17] It seems to be implied by this phrasing that information considered immaterial could not only be omitted but also misstated and possibly obscured, which would call for a reformulation ; be it as it may, this definition does highlight the fact that materiality should relate to decision-making by identifiable groups of stakeholders (in the present case, "primary-user of general-purpose financial reporting", i.e. investors and other financial market participants).

By contrast, the definition of impact materiality in ESRS 1 is deprived from its principal element of definition : indeed, any reference to decision-making by stakeholders has been removed. This gives the following tautological-sounding statement : "A sustainability matter is material from an impact perspective when it pertains to the undertaking's material actual or potential, positive or negative impacts on people or the environment over the short-, medium- or long-term".[18] Admittedly, the disconnection apparent in ESRS 1 between impact materiality and stakeholders' decision-making should be nuanced. Undertakings are required under ESRS 1 and ESRS 2 to engage with stakeholders when performing their materiality assessment, and to account for the outcome of these engagements in their sustainability statement.

However, there is ample evidence that engaging with stakeholders in the materiality assessment process does not imply that a firm will use criteria or set materiality thresholds responsive to stakeholders' actual expectations.[19] Moreover, under the principles set out in ESRS 1, the description of a sustainability matter as not being material grants firms the possibility to omit any information related to this matter, and whole sustainability standards may be ignored in this way. Therefore, firms are financially incentivised to dismiss the materiality of their impacts, and it should be expected that underreporting and/or inadequate reporting will arise.

[16] With regard to the possible consequence of (im)materiality, whether some pieces of information can be *totally* omitted as a result of their being immaterial remains somewhat unclear when one considers the traditional definition of materiality. Accuracy seems to impose that past financial transactions should be recorded at their exact amount, however small they may be. What the principle of materiality does authorise is that the accounting treatment of such insignificant transactions be simplified in a way or another (e.g. that very small investments be charged to expense in the current period instead of being spread over the usage period of underlying assets). However, when it comes to future financial transactions, and a fortiori when it comes to (implicit) transactions with non-human capitals or "nature" (i.e. what ESRS refer to as "impacts"), full omission of certain pieces of information deemed non-material is generally accepted. Hence the conception of materiality as a filter to determine which matter should actually be reported on. The latter conception is at the core of ESRS conceptual framework.

[17] Draft delegated act, ESRS 1, par 48

[18] Ibid, ESRS 1, par 43

[19] As a general rule, firms are tempted to use materiality, including impact materiality, as an opportunity to report only on matters that are most significant in their own eyes. These may be (we do not pretend to be exhaustive) sustainability issues which are already reflected in their policy agenda or sustainability issues which they expect might provide them a competitive advantage over their rivals. For more insight on this issue, see for example Jones, P., Comfort, D., & Hillier, D. (2016). Materiality in corporate sustainability reporting within UK retailing. *Journal of Public Affairs*.

To ease these problems, we offer the three following propositions. The first one relates to the definition of impact materiality.

We propose that the current definition of impact materiality in ESRS 1 par 43 be amended in such a way as to make clear the connection between materiality and decision-making. For example, it could be stated that "information on impacts should not be omitted when key stakeholders can reasonably be expected to determine or change their decisions depending on such information being brought to their knowledge".

(Proposition 2a)

In this way, financial materiality and impact materiality would be described under the same rhetoric, and it would become more manifest that the latter should be given (at least) as much importance as the former. Just as importantly, this reformulation would legitimise why certain specific items always need to be taken into account in firms' materiality assessment. Indeed, acknowledging that impact materiality is stakeholder dependent means that materiality criteria cannot be decided arbitrarily by organisations depending on their own and only judgement. Instead, impact materiality should always consider, inter alia, a list of minimal factors (e.g. size and composition of GHG emissions, endangerment of threatened species, contribution to systemic risk, etc.) presumed to be material for key stakeholders in the context of 21st-century ecological concerns – just as historically, financial accounting has imposed specific requirements on firms based on items (e.g. size and composition of assets, liabilities, provisions, etc.) presumed to be material for investors. The number of items within that list – items to be always considered by firms, no matter the nature or their activities, when assessing the materiality of their impacts – would reflect EU's overall level of ambition with regard to sustainability-related corporate accountability ; additional items, or more detailed ones, included in sector-specific standards, would reflect EU's particular vigilance towards certain high-risk activities.

Returning to ESRS set 1, a list of such minimal items has indeed been provided by EFRAG and included in the disclosure requirement ESRS 2 IRO-1. However, as already pointed out, the Commission has modified the table in ESRS 2 Appendix C (formerly Appendix B), seemingly removing application requirements related to ESRS 2 IRO-1 in topical standards from the list of mandatory requirements. Suh a change could undermine the provision of good information to stakeholders, as these application requirements contain detailed items and guidelines on how the materiality assessment should be performed (like the screening and breakdown of impacts according to site locations and business activities, to take only one example).

We propose that application requirements related to ESRS 2 IRO-1 in topical standards be reincorporated in ESRS 2 Appendix C, to clarify that these requirements should always be taken into account by undertakings when they perform their materiality assessment.

(Proposition 2b)

In addition, we join ESMA and many respondents to the present consultation in calling the Commission to provide further guidance on materiality thresholds, as the current conceptualisation (based on the distinction between severity and likelihood) leaves a lot of room for interpretation. Maybe a rule-based approach specifying legally binding materiality thresholds should be considered in specific instances (like GHG emissions).

In the meantime, it would be helpful to lower the financial incentive to omit disclosures through (mis)use of the materiality filter. Systematic justifications for such omissions, when they concern whole standards, would enable public authorities to be better informed of how undertakings set materiality criteria and thresholds, and more generally on how they comply with the CSRD. If large-scale underreporting or otherwise inadequate practices were to occur, it would be easier to identify and eventually prevent them through future improvements of the standards.[20]

It would be helpful to make the justification on why all disclosure requirements contained in a topical ESRS have been omitted (when applicable) mandatory. (Proposition 2c)

3. Future accounting developments

Finally, and more directly related to the research and experiments carried out in the EAC, we would like to highlight the following four areas of improvements in relation to ESRS future developments. Comments made in this section should be apprehended in the broader context of accounting policy and may therefore be taken into account in the longer run[21].

Firstly, we expect future revisions of ESRS to anticipate the likely evolutions of financial accounting practices in relation to sustainability matters, and, as a result, to impose a standardised nomenclature for disclosures on actions and resources linked to the management of material negative impacts.[22] Synthesising the latter into a comprehensive nomenclature (e.g. avoid, prevent, remediate, offset) would not only enhance comparability between firms, increase the reliability of the information disclosed, and enable a critical assessment of actions based on scientific judgement, but it would also and above all facilitate the integration of sustainability-related information into financial accounts, a prospect we believe will take on increasing importance in years to come.

In the meantime, and as a transitional step, it would seem very useful that undertakings classify their actions following mitigation hierarchies already proposed in topical ESRS.

We propose making the classification of each action according to a layer of the mitigation hierarchy in ESRS E2-E5 mandatory. (Proposition 3a)

Secondly, and closely related to the first point, it should be clarified how ESRS position themselves in the controversial debate between dynamic accounting and fair value accounting. Although ESRS should be equally adapted to both accounting practices, in line with the spirit of the Accounting Directive, we note that

[20] For example, ESMA rightly pointed out that certain phrasings in ESRS foster ambiguity about criteria and materiality thresholds to be used for the purpose of materiality assessment (see in particular par 47 of ESMA's official reply). Such ambiguities will be hard to assess and hard to correct in future stages of standard-setting if materiality assessment remains too much of a black box.

[21] However, propositions 3a and 3b (see below) are meant to be taken into account right away.

[22] ESRS already make useful distinctions between different categories of actions, and sometimes ask reporting entities to distinguish clearly between them in their reporting (e.g. GHG emission reduction vs GHG offsetting in ESRS E1). However, these distinctions are not conducive to a systematic accounting of how actions relate to impacts and how resources relate to actions. Indeed, information asked in ESRS 2 MDR-A remains very general. The current breakdown of resources by investment length (Capex vs Opex), useful as it may be from an investor's perspective, is vastly insufficient to comprehend the array of actions that can be decided and financed by firms in order to manage their negative impacts.

several provisions of ESRS concerning financial materiality implicitly assume fair value principles.[23] Particularly noteworthy in this regard is the notion, implied by ESRS 1 par 127b, that "macroeconomic or business projections" may be "relevant in estimating the recoverable amount of assets, the amount of liabilities [and the amount of] provisions in financial statements". When applicable, ESRS 1 par 125 requires[24] undertakings to make a consistency statement[25] detailing how such projections relate to data included in the financial statements. In the same spirit, ESRS 1 par 88 and AR15 require undertakings to use scenarios, forecasts, and sensitivity analyses, when trying to derive the expected financial effects from sustainability-related risks and opportunities, and when evaluating their materiality. ESRS 1 par 90 goes as far as to say that, "in judging whether information about possible future events is material", undertakings shall consider "the full range of [potential financial effects resulting from the event] and the likelihood of the [possible effects] within that range".

Full predictability demands of this kind are not only excessive in terms of added reporting burden, but they are also unrealistic and may even cause harm, as most events in the future (particularly when it comes to sustainability matters) are uninsurable in the Knightian sense. Spurious predictions of stability and continuity that undertakings may be tempted to allege under the abovementioned provisions, using a probabilistic rhetoric, will not prevent financial crises to happen but instead will make them worse when they happen, as everyone (and in the first place, investors) will have been misled into believing that such crises were not on the agenda. Above all, instead of *conjecturing* on what the future might look like, using costly financial tools whose predictions are, at best, uncertain, or, at worst, biased towards optimism, undertakings should be expected to explain how they *prepare*, here and now, to the uncertain future.

One cannot turn the uncertain future into a predictable future without also losing accountability;[26] but willful management decisions can make undertakings accountable, no matter the uncertain outcome of these decisions in the distant future. If *reporting* means also *accounting* and not only *conjecturing*, then reconciliation between sustainability and financial statements should be based, to the larger extent possible, on undisputable information already available to management bodies, namely past expenditures and financial budgets for future years (what ESRS call "resources").

We propose that indirect reconciliations between sustainability and financial statements be made mandatory in ESRS 1 par 124, when such reconciliations relate to past or budgeted resources aimed to address sustainability issues. Conversely, we propose that the consistency statement demanded in ESRS 1 par 125, and other demands made in ESRS 1 par 88, 127 and AR15, be made voluntary, inasmuch as these demands involve substantial levels of speculation.

(Proposition 3b)

Thirdly, we believe further clarification should be provided on the concept of "natural capitals". Although the Commission has deleted any reference to such capitals as being "factors of value creation", the wording

[23] This comes as no surprise since financial materiality in ESRS is almost completely aligned with IFRS principles. Yet, not all undertakings in the scope of ESRS are subject to IFRS, and fair value principles implicitly assumed by ESRS will be particularly difficult for them to comply with, especially if they are SMEs.
[24] We take this opportunity to signal that the paragraph quoted in ESRS 1 par 127 should be paragraph 125 rather than paragraph 123 ; if this mistake was not corrected, the required consistency statement would apply to items which are already, by their nature, consistent (par 123 refers to items which already can be directly connected).
[25] The word "consistency", as defined in ESRS 1 par 125, is used in a different acceptation than that in ESRS 1 Appendix B "Qualitative characteristics of information", which essentially means "continuity of accounting methods". This could create confusion.
[26] It is interesting in this regard that IASB renamed itself IFRS, substituting "financial reporting" for "accounting".

of ESRS 1 AR 14 and AR 15 remains implicitly oriented towards a productivist acceptation of the concept of capital.[27] Such an acceptation is not neutral from a conceptual perspective,[28] and given also its limitations on the practical side,[29] we advise that **future revisions should consider whether to substitute the current productivist approach to natural capital with a more conservative approach, especially one that recognises the non-economic value of natural capital.**[30]

Fourthly and finally, the question should be raised and thoroughly discussed as to whether financial materiality can be reduced to a mere assessment of "risks" and "opportunities", as suggested in ESRS 1. It seems particularly uncertain how financial commitments to reduce negative impacts should relate to this dichotomous picture, and it would seem unnatural that such financial commitments fall in the same category as passively-endured "risks" or "opportunities". **Maybe it would be interesting to assess whether the dichotomy "risk/opportunity" could be replaced by the trichotomy "risk/opportunity/obligation".**[31]

Signature

We hope that comments raised in this letter will be useful, and we stand ready to discuss them in further detail if given the opportunity.

Nicolas Zoubritzky, for the **Ecological Accounting Chair**.

A table synthesising our propositions can be found below (please see next page).

Appendix 1. Summary of propositions

[27] In ESRS, "capitals" appear in the context of financial materiality, and are described as intangible assets, although, according to ESRS 1 AR 15, "they [may not be] recognised as assets *from an accounting and financial reporting perspective*" (italics added). This implicitly means that such "capitals" should be recognised as assets *from an economic perspective* (inasmuch as they create value for the undertaking and investors).

[28] For a thorough discussion on the different accounting approaches to capitals, and particularly natural capitals, see Rambaud, A. (2023). *How can accounting reformulate the debate on natural capital and help implement its ecological approach?*, AFD research papers.

[29] Assigning an economic value to a natural capital is extremely hard, let alone if this value needs to reflect future cash inflows expected from "nature". Indeed, firms themselves consider the evaluation of such natural capitals as "not mature" – the statement comes from Elisabeth Gambert, CSR director of the French Association of Large Companies (AFEP) and Member of the EU Corporate Reporting Lab (EFRAG), and can be listened to in the following recording : https://www.youtube.com/watch?v=AL0NO7r-2Wg (discussions are held in French, and the passage in question is at 1:03:25).

[30] Multi-capital accounting approaches in strong sustainability like CARE (Comprehensive Accounting in Respect of Ecology), which is currently being developed and experimented by the EAC, provide examples of how natural capitals can be endowed with non-economic value and yet be incorporated within operational accounting frameworks.

[31] At first sight, this semantic revision would reduce interoperability between ESRS and IFRS/ISSB. However, reconciliation would be relatively easy as IAS 37 (Provisions, contingent liabilities and contingent assets) already provides for the possibility that firms may take on *implicit* obligations, beyond legal requirements.

Standard	Paragraph or AR or Appendix	Comment
All	**All**	**Proposition 1 – It would be helpful** if the Commission could disclose an official document listing every amendment it has made to the draft standards submitted by EFRAG in November, accompanied with a basis for conclusions detailing how ESAs' and other stakeholders' opinions were taken into account.
ESRS 1	Par 43	**Proposition 2a – We propose** that the current definition of impact materiality in ESRS 1 par 43 be amended in such a way as to make clear the connection between materiality and decision-making. For example, it could be stated that "information on impacts should not be omitted when key stakeholders can reasonably be expected to determine or change their decisions depending on such information being brought to their knowledge".
ESRS 2	App C	**Proposition 2b – We propose** that application requirements related to ESRS 2 IRO-1 in topical standards be reincorporated in ESRS 2 Appendix C, to clarify that these requirements should always be taken into account by undertakings when they perform their materiality assessment.
ESRS 1 - ESRS 2	Par 31 (ESRS 1), par 57 (ESRS 2)	**Proposition 2c – It would be helpful** to make the justification on why all disclosure requirements contained in a topical ESRS have been omitted (when applicable) mandatory.
ESRS E2-E5	Par 19 (ESRS 2), par 18 (ESRS 3), par 26a (ESRS 4), par 20 (ESRS 5)	**Proposition 3a – We propose** making the classification of each action according to a layer of the mitigation hierarchy in ESRS E2-E5 mandatory.
ESRS 1	Par 88, par 124, par 127 and AR 15	**Proposition 3b – We propose** that indirect reconciliations between sustainability and financial statements be made mandatory in ESRS 1 par 124, when such reconciliations relate to past or budgeted resources aimed to address sustainability issues. Conversely, we propose that the consistency statement demanded in ESRS 1 par 125, and other demands made in ESRS 1 par 88, 127 and AR15, be made voluntary, inasmuch as these demands involve substantial levels of speculation.