AFRAC
AUSTRIAN FINANCIAL REPORTING ADVISORY COMMITTEE

AUSTRIAN FINANCIAL REPORTING ADVISORY COMMITTEE
C/O KAMMER DER STEUERBERATER UND WIRTSCHAFTSPRÜFER
AM BELVEDERE 10 I TOP 4
A-1100 VIENNA
AUSTRIA

TEL +43 (1) 81173 228
FAX +43 (1) 81173 100
E-MAIL office@afrac.at
WEB http://www.afrac.at

February 2, 2024

EFRAG
Mr Patrick de Cambourg (SRB Chair)
35 Square de Meeûs
B-1000 Brussels (fifth floor)
Belgium

<u>Comments on Draft EFRAG Implementation Guidance – IG 1 Materiality Assessment and IG 2 Value Chain</u>

Dear Mr. Cambourg,

on behalf of the Austrian Financial Reporting Advisory Committee (AFRAC), the privately organised standard-setting body for financial and other corporate reporting in Austria, we appreciate the opportunity to comment on the Draft EFRAG Implementation Guidance documents "IG 1 Materiality Assessment" and "IG 2 Value Chain".

Principal authors of this comment letter were Laura Böhm, Lisa Diasek, Bernhard Gehmayr, Werner Gedlicka, Erich Kandler, Claudia Korntner, Aslan Milla, Gerhard Prachner, Alexander Schiebel, Cornelia Walch, and Alfred Wagenhofer (chair). In order to ensure a balanced Austrian view on the consultation, the professional backgrounds of these authors are diverse.

Best regards,
Romuald Bertl
Chairman

Draft IG 1: Materiality Assessment Implementation Guidance (MAIG)

General remarks (posted in comments on chapter 1 – Introduction)

AFRAC has concerns about a potential lack of consistency in reporting, particularly due to the discretionary nature of (i) the design of the materiality assessment process (MAIG, para 5 and 61) and (ii) the interpretation of "*appropriate*" in aggregating and disaggregating IROs (MAIG, para 78) and determining qualitative and quantitative thresholds (MAIG, para 81).

Comments on chapter 3.6 – Deep dive on impact materiality: Setting thresholds

AFRAC has concerns about the clarity of Figure 4 and Figure 5. Does Figure 4 imply that once at least one of the categories *Scale*, *Scope* or *Irremediability* is rated 4 on a five-point scale, an impact is classified as "*material*", while a rating of 3 (even if multiple categories are rated at 3) does not lead to a classification as "material"? Figure 5 suggests to the reader an asymmetrical treatment of *Severity* and *Likelihood*. While on a five-point scale a *Likelihood* of 5 is classified as *medium (orange)*, a severity of 5 would lead to a classification as *high (red)*. What are the implications of a medium classification for threshold values? A clarification that these are simply examples, but not a general approach to thresholds would be helpful.

Comments on chapter 5.3 – FAQs on the materiality assessment process

FAQ 13: Doing the materiality assessment when the undertaking operates in different sectors

As many undertakings will be required to produce consolidated sustainability reports, AFRAC believes that more guidance is needed on the consolidated view (group-wide view). In particular, how are results of an analysis summarized at the local subsidiary level and then "consolidated" at the group level? In order to provide more clarity on the issue, AFRAC would appreciate the inclusion of more examples. Further, AFRAC believes that it would be helpful to provide examples of how the materiality assessment process can be designed as a bottom-up or top-down approach (MAIG, para 180).

FAQ 14: Will the implementation of sector-specific standards create any new sub-topics or sub-sub-topics to be considered in the materiality assessment?

AFRAC believes that there are ambiguities in the treatment of sub-topics, which we illustrate with the following example: If a sub-topic is classified as "*not material*" according to the ESRS materiality assessment, but individual indicators, e.g., land sealing in the real estate sector, are considered as material in various other sector specific standards, how should this be handled? Should this indicator then be assigned to an ESRS sub-topic? Furthermore, do all datapoints from *Policies, Strategy, Governance, and Targets* need to be reported here, or is the reporting of the respective indicator sufficient?

AFRAC also believes that clarification is needed in the MAIG on how to deal with the materiality of individual sub-topics in the upstream value chain in order to facilitate the practicability of the ESRS standards. E.g., suppose a real estate group does not consider waste to be material, but it is material in the upstream value chain at construction sites. Can undertakings make exclusions in such cases?

There is a lack of references to the cross-cutting standards in the MAIG. In order to reduce the effort for undertakings, it would be desirable if, e.g., the KPIs listed in the ESRS for individual sub-topics were also listed in the MAIG in order to create a standardized reference work for undertakings.

Comments on chapter 5.4 – FAQs on stakeholder engagement

AFRAC believes that the MAIG in FAQs 15-17 is imprecise and unclear. The descriptions in ESRS 1 (para 22–24) leave substantial room for interpretation and the MAIG on this matter is very brief. AFRAC therefore suggests to expand the MAIG on this matter by stating that the decision-making on the internal materiality assessment need not involve outside stakeholders, but that it is advisable to liaise with all stakeholders on matters to be considered. AFRAC recommends referring to the generally accepted process of materiality assessments for financial reporting. With regard to FAQ 17, AFRAC believes there is a lack of specification of the topics/issues to be considered. AFRAC recommends using a list of risks and opportunities relevant to silent stakeholders across many sectors.

AFRAC encourages EFRAG to address the fact that users/readers of the sustainability information and affected stakeholder groups are not always congruent in the MAIG. How should such incongruency be included in the materiality analysis – is it insufficient to only include affected stakeholders?

Comments on chapter 5.5 – FAQs on aggregation/disaggregation

FAQ 19: Is an IFRS or local GAAP segment an appropriate level of disaggregation for the materiality assessment?
With regard to multi-segment undertakings, AFRAC believes that there should be more guidance including providing more illustrative examples on how to proceed when a group includes undertakings that are active in different business segment.

Comments on chapter 5.6 – FAQs on reporting

FAQ 23: When an undertaking has actions in place to avoid, minimize, restore or compensate environmental impacts, shall it report on the impacts before those actions?
With regard to the gross/net consideration of environmental impacts, we strongly believe that the MAIG is neither sufficient nor clear enough on this issue. AFRAC believes that a gross approach is more likely to generate comparable reports of undertakings.

Draft IG 2: Value Chain Implementation Guidance (VCIG)

Comments on chapter 2 – Navigating the value chain under CSRD and ESRS

Topic: Should IROs linked to all actors in the VC be considered?
AFRAC suggests referencing recommended or recognized tools (national or international) for the identification of IROs in value chains (e.g., for a CSR risk check) in the VCIG.

Topic: Operational control
AFRAC believes that the concept of operational control needs further clarification. First, we recommend clarifying that the concept of operational control is only relevant for the standards ESRS E1, E2, and E4 as VCIG, para 45 may create confusion about that by stating that "[…] *there may be circumstances where the concept (note: operational control) should be applied* […]". Second, the relationship between (or unrelatedness of) financial and operational control should be clarified. It is unclear whether or not there is there an overlap between these two concepts

and whether they are substitutes or complements. Consider the following example: Undertaking A owns the majority of shares in B and classifies B as a subsidiary, i.e., it has financial control. Undertaking C holds shares in B and has operational control over B's operations. Then, according to ESRS 1.62, undertaking A has to include 100% of B's emissions as scope 1 and 2 emissions, while, according to the concept of operational control, C has to include 100% of B's emissions as scope 1 and 2 emissions. Differences in the concepts may lead to double-counting of B's scope 1 and 2 emissions.

AFRAC considers the concept of operation control as particular challenging in the financial sector. VCIG, para 52 states that associates that are not actors in the value chain (i.e., investees only) are outside the scope of sustainability reporting (except for category 15 of the GHG Protocol), unless an undertaking has operational control over an associate or joint venture. It is not clear whether this conclusion equally applies to financial institutions and their associates. Credit institutions typically make both debt and equity investments, where equity investments may also be associates. AFRAC believes that the VCIG and ESRS 1.63 and 1.67 do not make all associates of credit institutions part of their value chain. It should be clarified whether associates of credit institutions are only actors in the value chain if they are part of the financial sector and thus part of the business model of the credit institution.

Comments on chapter 3 – FAQ 1: Where does the VC begin and end?

When analyzing and preparing the value chain for the sustainability report, there are limits to the information that can be compiled. Therefore, AFRAC suggests to include more guidance and clear specifications as to where the value chain begins and, in particular, where it ends (e.g., where business relationships cease to exist, where the undertaking no longer has any influence, etc.). In addition, AFRAC would appreciate examples of relevant risks and opportunities arising from business relationships outside the scope of accounting consolidation (VCIG, para 71 (b)).

Comments on chapter 3 – FAQ 7: How to assess and quantify the impacts of the VC resulting from business relationships?

AFRAC believes that further clarification and guidance is needed on the terms "*significant*" (in relation to materiality) and "*most significant*". We would like to refer to ESRS 1.42 which states that "*[...] Some existing standards and frameworks use the term "most significant impacts" when referring to the threshold used to identify the impacts described in ESRS as "material impacts"*. VCIG, para 130 includes an example of "*a small bakery*" for "*insignificant*" products, but examples that are less obvious would be helpful.

Comments on chapter 3 – FAQ 9: How can estimates be developed when primary data cannot be collected from VC counterparties?

AFRAC encourages EFRAG to provide a list of recognized databases (e.g., industry average data) and secondary data sources (e.g., secondary emission factors for standard materials) for the calculation of scope 3 emissions in the VCIG. Regarding the use of secondary data, AFRAC believes that more clarity is needed on the issue of how the accuracy resulting from the use of secondary data can be determined. Specific examples would be helpful.