Implementation guidance for value chain (VCIG)

Disclaimer

This implementation guidance is non-authoritative and accompanies ESRS but does not form part of it. This means that if anything in this guidance appears to contradict any requirement or explanation in ESRS, ESRS takes precedence. This implementation guidance is issued following EFRAG's due process for such non-authoritative documents and under the sole responsibility of EFRAG.

Contents

Summary in 8 key points

NB: this implementation guidance (IG) covers the upstream and downstream value chain (VC) of the undertaking and not its own operations.

1. The undertaking's sustainability statement shall include information about **all material impacts, risks and opportunities (IROs)** that arise or may arise in the context of its business relationships with actors **in its VC**.
2. The undertaking is **not required to include VC information in all disclosures**, but only when it is connected with material IROs beyond its own operations, due to its business relationships.
3. The connection with material IROs is **not limited to the first tier of relationships**.
4. Therefore, the **materiality assessment shall cover the identification of material IROs in the VC**, with a focus on where (geographies, activities/sectors, operations, suppliers, customers, other relationships, etc.) in the VC they are likely to materialise. Key **disclosures about the undertaking's materiality assessment** are SBM-1, SBM-3 and IRO-1 (ESRS 2). They are not limited to but should cover the assessment of IROs in the VC.
5. Topical standards require to include VC information when disclosing about **policies, targets and actions** when they cover material IROs in the undertaking's VC.
6. Topical standards require to include VC data only for a **few metrics**. However, when a material IRO that involve actors in the VC is not sufficiently covered by ESRS, the undertaking shall include **additional entity-specific metrics** when appropriate.
7. When the undertaking cannot collect primary VC information after making reasonable efforts, it shall **estimate** the missing information, using **all reasonable and supportable information available without undue cost and effort**, including proxies and sector data and other information from indirect sources. The undertaking shall describe in its basis for preparation the metrics using value chain estimation and the resulting level of accuracy.
8. The inclusion of VC information in the sustainability statement does not affect the undertaking's reporting boundaries, which correspond to the entities included in the **perimeter of its consolidated financial statements**. The inclusion of VC information is the extent to which the sustainability statement covers the relationships that all the undertakings in the consolidation perimeter have with their respective VC counterparts, including beyond the first tier. **Associates and other investees** which are not consolidated in the financial statements are treated as the other business relationships, i.e., as actors in the value chain when this is the case.

1. Objective

1. The objective of this guidance is to support the implementation activities of preparers and others using or analysing ESRS reports, in this case specifically on the value chain information in accordance with the requirements of Articles 19a or 29a of the Directive 2013/34/EU (referred to as the "Accounting Directive") as amended following the Corporate Sustainability Reporting Directive (referred to as "the CSRD").
2. The content of this document has been developed on the basis of the July 2023 delegated act.
3. In its implementation support function, EFRAG cannot develop concepts and reporting requirements that go beyond the content of the July 2023 delegated act, or interpret Union law. The purpose of the implementation support material is to illustrate how the provisions of the delegated act may be implemented without introducing new provisions. New provisions can only result from future standard setting activities (e.g. future amendments to draft ESRS), if and when applicable in accordance with the EFRAG due process.
4. As an illustration, when the implementation support documents point to a specific approach or methodology that is not detailed in the delegated act, this has to be framed as one of the possible implementation approaches without excluding other possibilities.
5. The document is organised into the following chapters.
   a) The next chapter covers how to navigate VC requirements in ESRS which is the basis for the rest of the document.
   b) The following chapter covers how an undertaking may implement VC under ESRS by using frequently asked questions with the aim of providing practical guidance.
   c) The last chapter includes the 'upstream and downstream VC map' that explains the coverage of the upstream and downstream VC as required by ESRS (excluding considerations of entity-specific disclosures and SFDR indicators).
6. To avoid duplication and reduce the length of this document, there is significant reference to the Materiality Assessment Implementation Guidance (MAIG) developed by EFRAG. For example, the due diligence aspects related to the materiality assessment (and VC aspects) are covered in that guidance rather than here.
7. Other acronyms used in this document are:
   a) CSRD – Corporate Sustainability Reporting Directive;
   b) ESRS – European Sustainability Reporting Standards;
   c) GHG – greenhouse gases or the GHG protocol;
   d) GRI – Global Reporting Initiative;
   e) IROs – impacts, risks and opportunities; and
   f) ISSB – International Sustainability Standards Board;
   g) MA – materiality assessment; and
   h) VC – value chain.

2. Navigating value chain under CSRD and ESRS

8. CSRD art 19(a)(3) and 29(a)(3) require that reported information relates to an undertaking's own operations and its upstream and downstream VC, including its products and services, its business relationships and its supply chain.

9. ESRS have been developed according to this legal requirement. CSRD does not provide any further definition or guidance about VC. However, with reference to impacts it refers to international instruments of due diligence which specify how the undertakings are expected to identify, address and report on impacts across their VC.

10. The definitions of 'value chain', 'actors in the value chain' as well as 'business relationships' are defined in Annex II of the July 2023 delegated act.

11. Not all the Disclosure Requirements (DRs) and datapoints in sector agnostic ESRS require to include information about the undertaking's upstream and downstream VC in the disclosures. In many cases the undertaking is expected to focus on its own operations. In particular:

    a) The general requirements relating to all disclosures on VC can be found in ESRS 1 *General requirements:*

        i. The requirements for reporting on the VC are in chapter 5;

        ii. Application Requirements AR 17 set out guidance on 'Estimation using sector averages and proxies'; and

        iii. Lastly, but importantly, ESRS 1 contains specific transitional provisions with respect to VC in chapter 10.2.

    b) ESRS 1 requires the inclusion of material VC information when this is necessary to allow users to understand the undertaking's material IROs and to produce information that meets the qualitative characteristics of information set for in Appendix C of ESRS 1 (ESRS 1 paragraph 65). This is a principles-based approach that works on top of the specific datapoints in ESRS that require to include specific VC information. This means that where necessary (i.e. reflecting the outcome of the materiality assessment), the undertaking shall include additional entity-specific metrics to cover VC (see ESRS 1 paragraph 11).

Further guidance in the MAIG:

- MAIG Chapter 4: MA – How is it performed?
- MAIG FAQ 2: What is meant by the undertaking being "connected" with an impact?
- MAIG FAQ 17: Should all the categories of stakeholders be considered or can the undertaking prioritise some of them? On which basis?

    c) ESRS required disclosures concerning the process and outcomes of the materiality assessment are covered in ESRS 2 *General disclosures* (IRO-1 and SBM-3), accompanied by SBM-1, as described out below in FAQ 4 How should information about the VC be disclosed in the context of the MA. For details about the materiality assessment process, please refer to the MAIG and for the related VC aspects please see FAQ 3 How should the MA process be organised to properly capture material IROs in the VC below.

    d) All the topical standards require undertakings to cover the VC in the disclosures about policies, actions and targets for material IROs. The VC is to be covered in such disclosures to the extent that those policies, actions and targets do involve or affect actors in the VC (see FAQ 5 *Should VC be included in PAT disclosures*). Within the disclosures about policies, actions and targets, the Social topical standards ESRS S2 *Workers in the value chain*, ESRS S3 *Affected communities* and *ESRS S4 Consumers and end-users* provide a framework for reporting on material IROs related to these groups of people in the VC and their management.

    e) There are only few metrics in topical ESRS that require to include VC information per se (see FAQ 6 *Should VC be included in metric DRs*). The Social topical standards for instance do not include metrics *per se*.

f) Finally, as explained under paragraph b) above, where necessary, following ESRS 1 paragraph 11, the undertaking shall include entity-specific metrics about its material IROs when they are not (or not sufficiently) covered by the topical standards.

12. **Chapter 4** of this document presents the **VC map** which illustrates the type of coverage of VC information that is required by each specific Disclosure Requirement in sector agnostic ESRS. This also includes which metrics require inclusion of VC data in the actual calculation.

2.1 What is the VC?

13. While the focus of this Implementation Guidance is on upstream and downstream VC, the definition of *Value chain* in Annex II of the delegated act is broader than the upstream and downstream VC, as it also includes own operations. VC is defined as *the full range of activities, resources and relationships related to the undertaking's business model and the external environment in which it operates. A value chain encompasses the activities, resources and relationships the undertaking uses and relies on to create its products or services from conception to delivery, consumption and end-of- life. Relevant activities, resources and relationships include:*

a) those in the undertaking's own operations, such as human resources;

b) those along its supply, marketing and distribution channels, such as materials and service sourcing and product and service sale and delivery; and

c) the financing, geographical, geopolitical and regulatory environments in which the undertaking operates.

Value chain includes actors upstream and downstream from the undertaking. Actors upstream from the undertaking (e.g., suppliers provide products or services that are used in the development of the undertaking's products or services). Entities downstream from the undertaking (e.g., distributors, customers) receive products or services from the undertaking.

ESRS use the term "value chain" in the singular, although it is recognised that undertakings may have multiple value chains.

14. According to this definition, the VC issues addressed in this implementation guidance include both upstream and downstream actors and their activities. Actors or undertakings upstream from the reporting undertaking (e.g., suppliers) provide products or services that are used in the development of the undertaking's own products or services. Actors downstream from the reporting undertaking (e.g., distributors, customers, waste management) receive, use or apply products or services from the reporting undertaking or waste stream by the customers or end-users at the end of life of products.

What is the difference between value chain and supply chain?

In short, the VC includes the supply chain. The supply chain is the actors in the VC upstream from the reporting entity. However, VC also includes downstream entities along with the supply chain.

The supply chain provides products or services that are used in the development of the undertaking's products or services. Depending on the position in the VC, an undertaking's supply chain can be part of the downstream VC of another undertaking.

In some industries, upstream or downstream refers to specific points in the chain rather than with reference to the reporting undertaking's position in the chain.

15. Some examples of the activities in sectoral value chains, can be found in Appendix A. Setting out the VC activities may help identifying the VC actors.

Should all the actors in the VC be considered?

16. When assessing material IROs, all relevant actors (both from direct and indirect relationships) are to be considered. However, the assessment should focus on relationships that are likely to be associated with material IROs, for example relationships with:

    a) those actors that are associated with 'hot spots' that expose to the likelihood of actual and potential impacts (therefore generating impacts for the undertaking, which can in turn be sources of risks and opportunities); or

    b) those actors with respect to which the business model of the undertaking shows key dependencies in terms of products or services (therefore generating risks and opportunities for the undertaking).

How to distinguish between the actors in the VC?

17. Common approaches to differentiate actors in the VC in relation to the determination of IROs are usually based on the following factors:

    a) proximity to business, e.g. tier 1, tier 2, tier N;

    b) connection to adverse impacts; and

    c) degree of leverage or influence of VC actor over the undertaking or vice-versa.

    The most important factor is b and determination should not be based primarily on a or c.

18. As noted in paragraph 22 below, lack of leverage does not determine materiality of the impacts or prioritising impacts for actions based on their severity. Also refer to MAIG Chapter 6.4 FAQ on Stakeholder engagement for further information about engagement with affected stakeholders.

19. Differentiation of VC actors can assist the undertaking in preparing the information as required by ESRS 2 SBM-3 explained in FAQ 4 How should information about the VC be disclosed in the context of the MA? below. Also refer to paragraph 79 below about the requirement to disclose the key features of the upstream and downstream VC.

How does leverage or influence over the VC impact reporting?

20. In some cases, an undertaking may have leverage or be able to exert influence over actors in its VC. Examples include where the undertaking is a large supplier or customer and so can exert its influence to manage sustainability matters arising from its business relationships and/or get the information it needs to prepare its sustainability statement.

21. In other cases, its ability to obtain the necessary VC information as well as its capacity to contribute to or influence the management of IROs arising in the VC, may be limited given the nature or the absence of direct contractual arrangements, the level of control that it exercises on the operations outside the consolidation scope and its buying power.

> **Alignment with ISSB and GRI**
>
> The definitions of value chain under ISSB and GRI frameworks are aligned with ESRS.

22. However, leverage does not affect whether IROs that arise in the VC are material or not. Leverage may affect the ability of the company to obtain data from its counterparties in the VC. This may be relevant for the reporting of material impacts as well as for reporting metrics and may lead the undertaking to use estimates and proxies.

2.2 Why does VC matter?

23. CSRD and ESRS require that the sustainability statement include information about the upstream and downstream VC.

24. The reason for this is that the major impacts, or major risks and opportunities deriving from impacts or dependencies, of a reporting undertaking often occur in its upstream or downstream VC rather than in its own operations. Therefore, focussing on own operations would provide only a partial picture of the contribution of the undertaking's activities to the impacts on people and the environment and would not allow for an appropriate identification of risks and opportunities.

    a) For example, consider an EU garment and apparel company that sells basic T-shirts produced in a country outside the EU by an external supplier and that reports under ESRS. The company may pay its employees an adequate wage under collective bargaining agreements for its operations in the EU. However, assuming the external supplier is based in a country outside the EU where the remuneration paid to the supplier's employees is below the adequate wage benchmark for the country and freedom of association in that country may not be allowed, the reporting undertaking would not provide a relevant depiction of its impacts if it was to consider only its own employees when determining the scope of its actual and potential material negative impacts. In other terms, material impacts on working conditions may be identified within the workforce in its upstream VC (for this particular supplier).

    > **Affected communities** suffer the consequences of the undertaking or its VC's operations. However, they are not necessarily part of the VC. For example, an affected community is part of the VC where it provides the land on which the mining takes place.

    b) Another example is a European retailer with wooden toys made in a factory outside the EU, where legal requirements are less stringent, and bribery and corruption of government officials may be evidenced. The toy-making process has several environmental and health and safety risks, due to dust and chemicals. There is therefore a significant risk that the workers and the local communities are exposed to severe occupational hazard exposures and health risks – important when considering impact materiality. From a financial materiality perspective, if the officials in that location start upholding laws including those relating to workers and the environment, it could result in significant fines or even possible closure for the manufacturer. This could have a direct and significant financial impact on the European retailer.

    c) Similarly, while a motor vehicle manufacturer may have some GHG emissions during the manufacturing process, it can be expected that most of the GHG emissions will occur during the consumer's use of the produced motor vehicle.

2.3 Inclusion of VC information on IROs of entities in the reporting boundary: operational controls, associates and other investees.

25. In the Accounting Directive, a group is defined as "*a parent undertaking and all its subsidiary undertakings*" under the definition of control per financial reporting. ESRS 1 paragraph 62 clarifies that the sustainability statement is for the same reporting entity as the financial statements. Therefore, for sustainability reporting, groups must include information about their subsidiaries and their IROs as part of their own operations even where transactions occur between the parent and the subsidiaries. In fact, the elimination of internal transactions following the financial accounting consolidation procedures for the preparation of the financial statements does not eliminate the underlying IROs that occur

in the group's operations, including the ones identified in the upstream and downstream VC of the subsidiaries.

26. In addition, ESRS 1 paragraph 67 states that when associates or joint ventures are part of the undertaking's VC, for example as suppliers, the undertaking shall include information required by ESRS 1 paragraph 63 consistent with approach adopted for other the other business relationships in the VC. Furthermore, when determining impact metrics, the data in relation to the associates or joint ventures are not limited to the share of equity held but shall be considered on the basis of the impacts that are directly linked to the undertaking's products and services through its business relationships.
27. ESRS E1 *Climate change* specifies how to apply this approach (paragraph 46) and requires including in the reported GHG emissions, the data of the joint ventures, associates, unconsolidated subsidiaries (investment entities) and contractual arrangements that are joint arrangements not structured through an entity (i.e., jointly controlled operations and assets), to the extent of the operational control of the undertaking over them.
28. Annex II of the July 2023 delegated act defines 'operational control' (over an entity, site, operation or asset) as *the situation where the undertaking has the ability to direct the operational activities and relationships of the entity, site, operation or asset*.
29. Whether referring to associates, joint arrangements and unconsolidated subsidiaries under operational control, ESRS E1 requires the inclusion of these entities' emissions separately from the ones related to the consolidated group for financial reporting (paragraph 50(b)).
30. It is important to note that where an undertaking has operational control it should separately consider the workers related to those assets or operations and determine whether they meet the definition of *own workforce* or *workers in the value chain* and refer to the disclosure requirements in ESRS S1 and S2 respectively.
31. The following table illustrates specifically how to treat impacts arising from investments of the undertaking depending on their accounting treatment in the financial statements:

	Common characteristic(s)[1]	Accounting treatment	Treatment for sustainability statement
Subsidiary	Control or 50%+1 of voting rights or de facto control when voting rights lower than 50%	Include 100% of assets, liabilities, income and expenses	Fully included (scope of consolidation is the same as financial reporting)
Associate	Significant influence, usually between 20% and 50% of voting rights; ability to influence the decision making through the appointment of a director to the board.	Investor recognises its share of profits and losses and add to value of investment in associate on balance sheet in a single line item (no proportional consolidation line by line)	• **Operational control:** GHG emissions: included to the extent of operational control. If the associate is also a counterparty in the VC: to extent of services/products used (ESRS 1 par. 67) • There are no specific indications in the sector agnostic standards on

[1] Please note that this is a very simplified description of the financial reporting requirements (and may differ between IFRS and local GAAP used in European countries) and so does not capture the nuances involved in classifying investments.

	Common characteristic(s)[1]	Accounting treatment	Treatment for sustainability statement
			how to treat IROs of associates where there is no operational control nor business relationship. This will be clarified in the sector ESRS.
Investments			There are no specific indications in the sector agnostic standards on how to treat IROs of investments. This will be clarified in the sector ESRS.
Trading	Less than 20% held for short term gain	Recognised at fair value; dividends in profit or loss.	
“Strategic”	Less than 20% not held for short term gain		
Joint venture	Joint control with rights to net assets of the arrangement. Always a separate entity.	Same as for associates	Same as for associates
Joint operation	Joint control with rights to assets, obligations for the liabilities relating to the arrangement. Not necessarily a separate entity.	Recognises its assets, liabilities, revenue, expenses including any share from items held jointly (proportional consolidation).	

2.4 Which IROs in the VC to disclose?

32. The two overarching requirements in ESRS 1 that are applicable are:
    a) paragraph 63 requiring information on material IROs connected with the undertaking’s upstream and downstream VC; and
    b) paragraph 11 requiring entity-specific information when a reporting undertaking concludes that a material IRO is not covered sufficiently by an ESRS, to enable users to understand such IRO. Such entity-specific information is expected to cover both IROs in own operations and IROs in the upstream and downstream VC, when they are material.
33. An impact may be material to the reporting undertaking if it arises in any part of the VC, including at any tier of its supply chain. In this regard, in the IRO assessment in the VC, the undertaking has to consider IROs that it may be connected to through its operations, products or services by business relationships. (Also see MAIG FAQ 2).
34. The identification of IRO in upstream and downstream VC is embedded in the materiality assessment (ESRS 1, Chapter 3 – Double materiality as the basis for sustainability disclosure). For further information about materiality, please consult the MAIG.

2.5 How do the transitional requirements work?

35. The general transitional provisions in ESRS 1 paragraph 131 onwards allow a temporary limit to the information on the VC to be reported during the first three years of reporting under ESRS. Specifically, preparers are required to consider VC in their materiality assessment, but the data gathering aspects are limited in the first three years.

36. The transitional provisions are intended to provide reporting undertakings with more time to prepare for the new reporting regime in case not all the necessary information regarding VC is available. The transitional requirements are optional, i.e., the undertaking can decide whether it wants to use them or not and they apply whether the VC actor is an SME or not.
37. The steps an undertaking can consider during this time may include:
    a) Stakeholder engagement and other enhancements to the materiality assessment;
    b) Preparation of technological and other infrastructure required for the reporting;
    c) Updating of contracts with actors in the VC to reflect status of new implemented policies or target tracking, such as foreseeing the provision of periodic information; and
    d) Improved knowledge about the structure of the VC, specific actors involved and associated impacts and dependencies.
38. The transitional requirements (ESRS 1 paragraph 132) foresee that if not all the necessary VC information is available during the first three years of the reporting undertaking's sustainability reporting under ESRS, the undertaking shall explain:
    a) The efforts made to obtain the necessary information;
    b) The reason why it could not obtain the necessary information; and
    c) Its plans to obtain the necessary information in the future.
39. However during the transitional period, reporting undertakings are expected as a minimum to use in-house data (such as data available to the undertaking and publicly available information) to disclose information on policies, actions and targets for the VC (ESRS 1 paragraph 133 (a)).
40. In addition, with reference to metrics, the undertaking is not required to include upstream and downstream VC information, except for datapoints derived from other EU legislation, as listed in ESRS 2 Appendix B (see ESRS 1 paragraph 133 b)).
41. Starting from its fourth year of reporting under ESRS, the undertaking shall include VC information according to ESRS 1 paragraph 63 (ESRS 1 paragraph 135).
42. In addition to the transitional provisions described above, Appendix C of ESRS 1 specifies that for ESRS E1-6 *Gross Scopes 1, 2, 3 and Total GHG emissions,* undertakings or groups with less than average of 750 employees at balance sheet dates, may omit datapoints on Scope 3 emissions and total GHG emissions for the first year of preparation of their sustainability statement. Similarly, the disclosure requirements for ESRS S2 *Workers in the value chain*; ESRS S3 *Affected communities* and ESRS S4 *Consumers and end-users* may be omitted for the first two years by undertakings who have 750 or less employees during the financial year.

Transitional provision with respect to entity-specific disclosures

43. While not exclusively related to the VC, given that entity-specific disclosures may trigger the inclusion of VC information, the transitional provision applying to entity specific disclosures (ESRS 1 paragraph 131) is also relevant here.
44. Until the effective date of the future sector ESRS, when the reporting undertaking is defining its entity-specific disclosures, it shall as a priority:
    a) Include disclosures it previously reported (where these meet the qualitative characteristics of information per chapter 2 of ESRS 1); and
    b) Add disclosures to cover those material sustainability matters in its sector(s). This additional disclosure shall be based on available best practice and/or available frameworks (such as IFRS or GRI sector-specific requirements).

45. This transitional provision is also applicable during the preparation of the first three annual sustainability statements.

2.6 What is the LSME cap and does it impact my disclosures?

46. Article 29b (4) of the CSRD limits the VC information that the ESRS may require undertakings in scope of the CSRD to obtain from small-medium enterprises (SMEs) for their reporting under ESRS. In particular, ESRS shall not specify disclosures that would require undertakings to obtain information from SMEs in their VC when such information would exceed the information to be disclosed pursuant to the ESRS for listed SMEs ('LSME') referred to in Article 29c.

47. This limitation is often referred to as the 'LSME cap' and it aims at limiting the burden for SMEs and embed proportionality in the ESRS.

48. EFRAG expects to be able to consult on LSME Exposure Draft toward the end of 2023 and one of the aspects to cover in the consultation is the approach to the implementation of the LSME cap.

49. In the development of LSME Exposure Draft[2], one of the driving principles has been the need to preserve to the maximum extent possible the integrity of the VC disclosures that will be prepared by the large undertakings applying the sector agnostic standards. Depending on the outcome of the consultation, once the content of the final LSME ESRS is finalized, it will be possible to assess whether amendments to the VC provisions of the sector agnostic standards will be finally required in order to align with what is required in LSME.

3. Frequently asked questions

50. This chapter provides further practical guidance on the VC principles described in the previous chapter.

FAQ 1: Where does the VC begin and end?

51. ESRS does not require information on each and every actor in the VC, but rather the inclusion of material VC information, i.e., when material IROs arise in the VC.

52. ESRS requires the undertaking to identify and assess **material IROs** across its entire VC from a double materiality perspective. In this regard:

    a) relevant impacts are defined as those that are connected with the undertaking, which includes when they are either caused by or contributed to or that are directly linked to the undertaking's operations, products or services through a business relationship. The relevant impacts are not ringfenced by proximity or contractual relationship, but by the fact that they occur in connection with the processes at any stage of the VC that contribute to the undertaking's operations, products or services, or that result from the use or end-use of those products or services. Conversely, the impacts of actors in the value which are not directly linked are outside of the scope of impact materiality (Also see MAIG FAQ 2); and

    b) relevant risks and opportunities are those attributable to business relationships, in particular with actors in the VC that are beyond the scope of consolidation used for the preparation of financial statements (ESRS 1 par. 49).

53. To assess potential and actual impacts, it is important that the undertaking identifies in particular:

[2] At the date of issuance of this working paper, the last publicly available information about LSME can be found in the Agenda Papers for the SR TEG meeting on 13 July 2023.

a) the location and characteristics of suppliers including beyond the first tier of their supply chain;

b) the users of their services and goods;

c) how the goods are treated in terms of waste at the end of their life; and

d) who may be affected by their services and goods.

54. See FAQ 7 How to assess and quantify the impacts of the VC resulting from business relationships? below for recommendations on how to organise the processes to identify and assess material impacts across the VC.

55. To assess risks and opportunities, the undertaking considers its own dependencies on natural, human and social resources and identifies potential changes in the availability, price and quality of such resources that may derive from sustainability matters affecting the actors in its upstream and downstream VC, including actors that are not in its accounting consolidation perimeter. The following two examples illustrate this concept:

a) A company in the automotive sector has a tier-1 supplier, producing steel for the main components of its final products, in a region with water scarcity. For producing steel, the supplier needs minerals from a mining company which is heavily dependent on a supply of water. As such, this supplier would be at risk if one of the mines was no longer able to access sufficient water from its existing sources. Consequently, the steel supplier may face physical risks in the future due to the water scarcity in the region, which could lead to operational disruptions and increased costs. This situation could lead to discontinuities in the supply of steel with disruptions in the automotive production.

b) A company active in the food sector needs to be constantly supplied with natural key inputs (such as flours). One of its main suppliers is active in a region at high risk of biodiversity loss and following the request by local authorities to restore damaged habitats it has a more variable production of key natural inputs and higher production costs. This situation could lead to disruptions in the supply of key natural inputs with consequences in the production of the company active in the food sector.

FAQ 2: Are financial assets (loans, equity and debt investments) considered business relationships that trigger VC information?

56. In short, yes. Business relationships and VC as defined in Annex II of the July 2023 delegated act does not exclude specific types of activities and relationships with actors in the VC.

57. ESRS 1 AR 12(b) illustrates that where the reporting undertaking provides financial loans to another enterprise that ultimately results in the contamination of water and land surrounding the operations of such enterprise, this negative impact is connected with the reporting undertaking by way of the relationship created by the loan agreement.

58. EFRAG plans to work on the development of further draft standards or guidelines for Financial Institutions and on that occasion, specific solutions will be consulted on for comments.

FAQ 3: How should the materiality assessment process be organised to properly capture material IROs in the VC?

1. Basic principles

59. ESRS require that the undertakings identify material IROs across their entire VC. As outlined in the *MAIG, section 4 Materiality assessment – how is it performed?*, the

undertaking should design a process that is fit for purpose as required by ESRS 1 chapter 3 and disclose per the requirements set out in ESRS 2 IRO-1.

60. In this respect, the structure of the double materiality assessment process should be proportional to the size and complexity of the undertaking's VC and the nature of the IROs that can be reasonably expected in such VC.

61. ESRS require material IRO information related to the VC, but not information on each and every actor in the VC. Therefore, undertakings should focus on the parts of their value chains where material impacts are most likely to occur.

62. Since the ESRS requirements for the impact materiality assessment foresee the use of due diligence processes, the materiality assessment will reflect the criteria for prioritisation of general areas for due diligence. If so, the undertaking can identify general areas where the risk of impacts is most likely to arise and prioritise these. This approach may take a form of a heat map where the undertaking evaluates what parts of its VC are likely to have higher negative or positive impacts or risks or opportunities.

2. Materiality assessment steps

63. The general guidance on the organisation of the materiality assessment process can be found in the *MAIG, section 4 Materiality assessment – how is it performed?* As explained there (emphasis added): *ESRS do not mandate how the materiality assessment shall by conducted by an undertaking, or how the process should be designed. No one process would suit all types of economic activities, location(s),* ***business relationships or value chains*** *(upstream and/or downstream) of all the undertakings applying ESRS. An undertaking, based on its specific facts and circumstances shall design a process that is fit for purpose considering the requirements of ESRS 1 Chapter 3, and what needs to be disclosed regarding the materiality assessment and its outcome (see ESRS 2 IRO-1, IRO-2 and SBM-3). Therefore, the ESRS provide several aspects that an undertaking takes account of when designing the materiality assessment process.*

64. With this caveat, the *MAIG* provides guidance for the general organisation of the MA process. The guidance below reflects how VC aspects can be incorporated in the possible process.

Step A. Understand the context and definition of the stakeholder engagement strategy

65. As explained in the *MAIG*, the first step in the MA process is about understanding the context in which the undertaking operates. Therefore, the undertaking needs to understand its VC in terms of business actors involved, sectors or nature of their activities, geographical locations, and processes. This is a prerequisite for the identification of where IROs are likely to arise.

66. The context also includes understanding the undertaking's strategy and business model and how they are connected to possible material IROs.

67. The strategy of the undertaking will influence its business model which will focus on its own operations but also include aspects around its up- and downstream value chain. All of this will impact its materiality assessment.

68. The undertaking should trace or map its VC activities and actors to identify whether and which parts of its value chains are in areas of heightened risks. For example, a chair manufacturer may use products such as steel, wood, foam and fabric in its business. These raise questions around origin of components (oil used to produce foam and cotton for the fabric) and the transport to the undertaking. Are there any environmental (deforestation, biodiversity, water usage) or social issues (working conditions, impact on communities) in countries of origin of the components? What are the sustainability matters

pertaining to the consumers? Here the sales channels may be relevant as well as the ability to re-use, re-cycle or up-cycle the furniture at the end of its life.

69. If the undertaking does not have reliable information on the geographical location of the stages of its VC (likely to be more relevant beyond the first tier), it should map the IROs associated with global value chains for materials, products and services it uses or produces, to the extent that they are relevant for its VC.

70. As explained in the general instructions in the *MAIG*, the undertaking should also identify [likely] affected stakeholders and consider how to engage them. See also *MAIG FAQ 19 What is the role of silent stakeholders and how to engage with them?*

Step B. and Step C: Identification of potential and determination of actual IROs

71. Identification and assessment of impacts can be challenging for those parts of the VC where the undertaking is not able to trace the materials and products. ESRS 2 paragraph 5 c) requires a description of the extent to which the disclosures cover the undertaking's upstream and downstream VC.

72. A good understanding of its purchasing practices and of the related actual or potential effects on the VC is key. For example, if the buying price does not cover the cost of a product bought, it will have a negative effect on the VC. If the purchasing department of the reporting entity do not understand lead times or ignore lead times when ordering this could have a negative effect on the workforce of their contractual partners in terms of overtime, accidents or use of forced labour.

73. The undertaking should aim to gather reliable data from actors in its VC. If this is not possible after having made reasonable efforts, it may rely as appropriate on sources of secondary data. Secondary data include information such as publicly available reports and studies, sector proxies, data from local, regional or national authorities, newspaper articles, databases, etc. to estimate the IROs.

Assessment of the involvement of the undertaking with the VC

74. The undertaking should provide information on whether it is involved with material impacts because of its business relationships (ESRS 2 SBM-3 paragraph 48 (a)).

75. As explained in *MAIG, FAQ 2* the undertaking may for instance be involved in a breach of labour standards through its procurement and payment policies and practices, or even by sourcing from suppliers whose business strategy is based on abusing labour rights.

76. The contribution to the impacts in the VC may obviously concern direct business relationships. However, the undertaking may find itself contributing to impacts that occur in more distant parts of the VC. This may for instance be the case when the undertaking or its direct suppliers are using commodities or components whose production is associated with severe systemic impacts, such as palm oil or coltan. Similarly, the undertaking may be contributing to impacts that are a result of the use of its products such as oil and gas derived fossil fuels, plastics contributing to microplastics pollution, cigarettes, or pesticides.

FAQ 4: How should information about the VC be disclosed in the context of the materiality assessment?

77. The disclosure of information about the VC is required in two steps, as a component of (i) the materiality assessment process and of (ii) the outcome the materiality assessment.

BP-1 – General basis for preparation of the sustainability statement

78. ESRS 2 paragraph 5(c) requires disclosing to which the extent the sustainability statement covers the undertaking's upstream and downstream VC. Therefore, in addition to metrics,

this applies to all the steps below, to the extent that material IROs arise in the upstream and downstream VC.

SBM-1 – Market position, strategy, business model(s) and VC – 'VC mapping'.

79. To provide an understanding of where in the undertaking's VC material IROs may arise, ESRS 2 paragraph 42(c) in SBM-1 requires the following description of its VC:
    a. the main features of its upstream and downstream VC;
    b. the undertaking's position in its VC;
    c. description of the main business actors and their relationship to the undertaking:
        i. key suppliers,
        ii. key customers,
        iii. key distribution channels,
        iv. key end-users.
80. Identifying the key actors requires judgement, to reflect the specific circumstances of the undertaking's VC and should consider both impact and financial materiality criteria.
81. The mapping of the VC for material impacts is expected to leverage on the sustainability due diligence process that is in place. However, the due diligence process may go beyond such mapping *per se* as explained below, looking at the impacts throughout the VC and identifying potential 'hot spots' by cross-referencing countries where materials are produced to social and environmental risk databases (i.e., Type of impact by Country by Actor in the VC). These hotspots may then be further investigated during the materiality assessment.

IRO-1 – VC considerations in MA

82. Subsequently, the undertaking shall describe its materiality assessment process, including in relation to the VC, and the extent to which it is informed by the due diligence process.
83. IRO-1 paragraph 53 (b) (ii) requires an overview of the process to identify, assess and prioritise the undertaking's impacts it is involved through its own operations or because of its business relationships. Similarly, paragraph 53 requires disclosing an overview of the process used to identify, assess, prioritise and monitor risks and opportunities that have or may have financial effects, which may arise due to its business relationship in the VC. In fact, the business relationships in the upstream and downstream VC shall be considered also in the context of assessing the materiality of risks and opportunities and not just for impacts (ESRS 1 paragraph 66).
84. The disclosure that meets these requirements could be structured in the following way:
    a) the types of relationships in the VC that were considered in the materiality assessment;
    b) the methods the undertaking used, and
    c) the sustainability topics that were evaluated.
85. For impacts, based on the initial mapping, the undertaking may focus on areas where actual or potential impacts could arise, which in turn reflects areas where the negative impacts are or could be severe. The undertaking will reasonably focus:
    a) on different types of business relationships and VC segments for different sustainability matters;
    b) on areas of heightened risk of adverse impacts, affected stakeholder engagement and prioritisation based on criteria of severity and likelihood.

86. For risks and opportunities, this should include how the process considered any other factors in the VC that are sources of IROs, including dependencies from natural and social resources.

IRO-1 - MA methods and assumptions

87. IRO-1 requires information on methods and assumptions applied in the materiality assessment (ESRS 2 paragraph 53(a)), including thresholds to determine materiality (paragraph 53 b (iv)). This should account for any specifics related to the VC. As per ESRS 2 BP-1, the undertaking should describe the extent of any limitations on the materiality assessment process with respect to the VC.

SBM-3 - Disclosing the outcome of the MA

88. As a result of the materiality assessment, the undertaking shall disclose the material IROs originating its VC. ESRS 2 SBM-3 paragraph 48 (a) requires disclosing *"where in its business model, its own operations and its upstream and downstream value chain these material impacts, risks and opportunities are concentrated".*

89. The preparation of this disclosure may use the evidence of impacts from the due diligence process, such as the concentration of types of impacts by country or operational step.

90. SBM-3 also requires describing the material impacts identified following the materiality assessment process disclosed under IRO-1: *"whether the undertaking is involved with the material impacts through its activities or because of its business relationships, describing the nature of the activities or business relationships concerned" (ESRS 2 paragraph 48 c) iv)).*

91. Paragraph 48 b) of ESRS 2 requires as well disclosure of: *"the current and anticipated effects of its material impacts, risks and opportunities on its business model,* ***value chain****, strategy and decision-making, and how it has responded or plans to respond to these effects, including any changes it has made or plans to make to its strategy or business model as part of its actions to address particular material impacts or risks, or to pursue particular material opportunities".*

92. This implies that when strategically important hotspots for VC IROs have been identified, SBM-3 requires information about discussions of the impacts at the relevant managerial level or governance bodies in charge (Paragraph 48(b)).

93. The disclosures should be consistent with the corresponding information on whether and how the VC was considered in the materiality assessment.

94. The information required by SBM-3 paragraph 48 (a) and (b) (such as effects on and changes of the VC, business strategy and policies, actions and targets adopted by the undertaking) should enable an understanding of the undertaking's basic ability to influence those IROs, and any potential effects on the undertaking.

FAQ 5: Should VC information be included for Policies, Actions or Targets (PAT) Disclosure Requirements?

95. Yes, VC information forms part of all disclosure requirements in the topical ESRS related to policies, actions and targets (ESRS 2 paragraphs 64(b), 67(b) and 70(b)).

96. Where the undertaking has policies, actions and targets relating to the VC, it should disclose this. Therefore, where a policy, action or target involves all or some VC actors that should be disclosed. Examples could include:

    a) policies to prevent and control pollution by its VC actors;

    b) policies against bribery and corruption for VC actors and training for them;

c) actions and resources related to pollution as well as targets to reduce pollution generated by a supplier (ESRS E2 *Pollution* AR 13 and 19);

d) clauses regarding the respect of fundamental human rights in contracts with VC actors;

e) audits conducted on high-risk suppliers;

f) selection criteria for new suppliers such as the existence of effective grievance mechanisms or freedom of association; and

g) targets for suppliers on sustainable material use for example X% recycled content or X% less waste.

97. As a reminder, the undertaking can comply by disclosing that it has not adopted policies and/or actions with reference to the relevant sustainability matter and provide reasons for this. It may also report a timeframe in which it aims to adopt them (ESRS 2 paragraph 62). The same applies to targets (ESRS 2 paragraph 72).

98. When providing information required by ESRS SBM-3 on material IROs or PAT, qualitative information may be sufficient (for instance for human rights policies with respect to the VC). However, quantitative information may be required to help users understand impacts, their severity and likelihood and/or track the effectiveness of actions to manage them. For example, where the undertaking uses a weight metric to track effectiveness with respect to a waste management target, the information will have a quantitative aspect.

99. As a reminder, in addition, the undertaking should always consider the need to provide entity-specific information. Please refer to paragraph 32.b) above.

FAQ 6: Should VC information be included for Metrics Disclosure Requirements?

100. Mostly not. DRs related to metrics cover only own operations except for entity-specific disclosures and for a few specific DRs:

a) Disclosure Requirement ESRS E1-6 *Gross Scopes 1, 2, 3 and total GHG emissions*;

b) Disclosure Requirement ESRS E1-7 *GHG removals and GHG mitigation projects financed through carbon credits*; and

c) Disclosure Requirement ESRS E4-5 *Impact metrics related to biodiversity and ecosystems change*. Specifically, ESRS E4-5 includes a metric of number and area of sites in or near protected areas or key biodiversity areas, that explicitly covers sites that are leased or managed in or near such protected areas. (ESRS 4 paragraph 35). ESRS E4-5 also specifies that where the undertaking has identified material impacts with regards to land-use change or impacts on extent and condition of ecosystems, it may disclose their land-use based on a Life Cycle Assessment. (ESRS 4 paragraph 36).

101. With reference to the social standards, ESRS S2 *Workers in the value chain* and S4 *Consumers and end users* cover the VC by definition. ESRS S3 *Affected communities* address impacts on communities affected directly by the undertaking as well as by the actors in the VC. These standards do not specify any standardised metrics. If the sustainability matters covered in these standards are assessed to be material, ESRS require the undertaking to provide relevant disclosures.

102. Beyond the specific provisions on metrics in the sector agnostic ESRS, the undertaking shall provide additional VC information metrics or integrate VC data into their metrics, when according to the outcome of its materiality assessment, this is necessary from an entity-specific perspective (ESRS 1 paragraph 11 and AR 1 to 5). In particular, ESRS require the undertaking to consider appropriate entity-specific metrics needed for understanding of the impacts or tracking effectiveness of companies' actions. Possible examples are the following:

a) impact data of suppliers should be included in the reported metrics, when the undertaking depends in its supply chain from activities that have a high impact on the environment;

b) the percentage of workers in value chains in high-risk areas being covered by social security schemes; and/or

c) the percentage reduction in health and safety incidents.

103. It is important to note that this is relevant only for those VC actors that are associated with material IROs and not for all VC actors.

104. Sector-specific ESRS will cover the inclusion of VC data in its impact metrics when relevant. In the transition period until the ESRS sector standards are available, the undertaking as part of its entity-specific disclosures shall consider this aspect and take inspiration from the available best reporting practices (see ESRS 1 paragraph 131(b)).

FAQ 7: How to assess and quantify the impacts of the VC resulting from business relationships?

105. For the materiality assessment and for the inclusion of VC data, the undertaking may either obtain information directly from actors in its VC or use estimates or proxies or combine both approaches.

106. Obtaining information directly is the most appropriate approach in certain cases, for instance for major tier 1 suppliers (the direct and substantial contractual relationship is a good basis for organising appropriate flows of data) or for customers of products and services in particular when they are end-users (the undertaking knows the parameters of its products and services). When this is the case, the undertaking may need to ask its suppliers and other relationships for information enabling the quantification of the impacts. The undertaking may use questionnaires, surveys and audits to obtain the information. Its buying power and overall contractual influence may help in this regard.

107. Such an approach may improve over time since VC actors may not be able to quantify their impacts yet but may be in a position to do so in the future given evolution of sustainability reporting. Therefore, supporting such actors to set up effective systems may be important to obtain reliable data. It may also be advisable to engage with them and where relevant, also encourage them to do the same with their value chains.

108. Generally, the effort placed on actors in the VC should not be disproportionate. E.g. the undertaking does not need to query all direct suppliers and could exclude those that deliver insignificant products or services to the undertaking (e.g. a small bakery that delivers pastries once or twice a year for events the undertaking hosts).

109. As further explained under FAQ 9 How can estimates be developed when primary data cannot be collected from VC counterparties?, the undertaking shall estimate the impact when it cannot collect the necessary data after reasonable effort. Estimates and proxies may be used in combination with information obtained directly as well. Using estimates, similar to financial reporting, is acceptable if organised under a process designed to comply with the characteristics of quality expected from sustainability information. Estimates and proxies may currently be the only available solution to quantify impacts in certain cases, due to unreasonable efforts required to collect data. Examples include tier 2 or tier N suppliers; tier 1 suppliers when they are excessively high in number; customers when they are not end-users (e.g., when the undertaking delivers products or services that are further transformed before contributing to the delivery of products and services to the end-users).

110. An example where obtaining primary data may not be possible and estimates may be used is a beverage company that advises that its drinks are best served cold, i.e., using refrigeration capacity and it has determined energy use as a material matter. This

undertaking would find it impossible to precisely measure its impact with each and every customer. However, from its materiality assessment, it assesses that electricity use is a significant part of its impact in the downstream VC. In this case, estimating its impact would involve considering variables such as volumes sold, average time the inventory will be cooled before consumption and an estimate of the average electricity used to cool its products on a unit basis. Depending on its assessment of the materiality of electricity use, the undertaking may want to provide a sensitivity analysis of its electricity use depending on reasonably possible changes in the important variables in its calculation. Proxies are often available at sector or product level. In all cases the undertaking shall clearly explain the basis for its estimates and the proxies used as well as any factor affecting their consistency over time.

111. ESRS 2 paragraph 10 requires the undertaking to disclose the metrics that include VC data estimated using indirect sources, including the basis for preparation, the resulting level of accuracy and the planned actions to improve accuracy in the future.

FAQ 8: What is ‘reasonable effort’ to collect VC data?

112. In the preparation of its sustainability statement, the undertaking uses detailed information about its upstream and downstream VC only to the extent that this is compatible with a reasonable effort (ESRS 1 paragraph 69). In all other circumstances, it shall estimate the missing information based on “*all reasonable and supportable information that is available to the undertaking at the reporting date without undue cost or effort”* (ESRS 1 paragraph AR17). This includes estimates, sector-average data and other proxies. For example, an undertaking could use country and sector statistic-based risk assessment data. If more details are known, such as the specific location of farming and manufacturing processes, more specific data may be available.

113. ‘Reasonable effort’ and ‘undue cost or effort’ relate to the processes put in place by the undertaking to collect VC data and to the amount of resources dedicated to these processes. It is generally considered that the undertaking should determine the best available way to prepare meaningful VC information (on the bases explained under FAQ 7) and dedicate proportionate resources once the degree of difficulty has been properly assessed. “Reasonable effort” cannot be an excuse for no action.

114. As explained above, the undertaking should report on material IROs in its own operations and in its upstream and downstream VC. In this context, putting the appropriate processes in place is a matter of management decision, internal organisation and allocation of resources. For VC data, a good starting point is a deep understanding of what, where and how the inputs for its products and/or services are sourced upstream and/or its products and services are brought to market downstream.

115. ESRS 1 paragraph 68 indicates that the undertaking’s ability to obtain VC information may vary depending on factors such as its contractual arrangements, the level of control it may exercise beyond the consolidation perimeter and its buying power. Therefore, there are cases where obtaining the information may be more challenging.

116. In the context of materiality assessment, the focus on the VC and VC information should be on where the undertaking is expected to have severe negative impact (on people and the environment). This means that general impact assessments could be useful for the initial work on collecting VC information. Examples include general information about the undertaking’s region or sectors of sourcing. For example, where an undertaking is sourcing its products mostly indirectly from Country A and Country B, it may look at available general information about the minimum wage in those countries when considering its social impacts. In Country A the minimum wage is generally 100% to 120% of the living wage but in Country B the minimum wage is less than 80% of the living wage. Therefore, the exposure to significant impacts is more likely in Country B, all other aspects being constant.

117. Determining what is a 'reasonable effort' and 'undue cost and effort' depends on facts and circumstances specific to the undertaking. On the basis of FAQ 7, using free and publicly available information may in some cases be considered a reasonable effort. In determining whether an action is beyond 'reasonable effort' and 'undue cost', the undertaking shall balance the reporting burden of obtaining direct data and the potential lower quality of the information resulting from not undertaking that action. In this context it is important to note that the estimation procedures adopted by the undertaking when direct data are not used, are expected to produce reporting that meets the qualitative characteristics of quality.

118. The undertaking should document clearly its efforts, the outcomes and how the information has been incorporated in its reporting process. It can also document alternatives considered and rejected as well as its reasoning. Such documentation does not have to be complicated but can set out the number of surveys sent out, how it determined to include relevant relationships and then the responses received. It can explain how it evaluated the quality of the information received and how this was incorporated in the materiality assessment or the reporting.

119. The availability of such a documentation constitutes evidence for the administrative, management and supervisory bodies and the auditors regarding the actions the undertaking had taken and why it considered these to be reasonable.

FAQ 9: How can estimates be developed when primary data cannot be collected from VC counterparties?

120. As discussed in paragraph 11.b) above, VC information is not required for all disclosures in the sustainability statement. However, where the undertaking determines that VC information is required and primary information (i.e., directly collected from the actor in the VC) is not available, estimated data can be used.

121. When collecting the necessary information from counterparties in the VC is not possible after reasonable effort, ESRS require that the reporting undertaking estimate the missing information, using internal and external information. Such estimates can be used either for assessing material IROs, or for disclosing metrics in the VC, as outlined in ESRS 1 Chapter 5.2. When assessing material IROs in the VC, a combination of primary (i.e. directly collected from the actor in the VC) and estimated data (using secondary data as input) can be employed.

122. Secondary data include data from indirect sources, sector-average data, sample analyses, market and peer groups data, other proxies, or spend-based data.

> **Examples of external data sources**
>
> - Academic institutions such as the Environmental Performance Index,
> - Government bodies such as the US Department of State's Social Progress Index,
> - Non-profit organisations such as the World

123. The text box opposite shows some sources of such data. Some of these require a fee and are provided as examples, but ESRS do not require the use of fee-based external sources. These are examples of external sources that help address environmental, social, human rights, and corruption matters.

124. It is difficult to quantify impacts caused by indirect business relationships where the undertaking does not have a direct contractual relationship and has less leverage. In this case, if the undertaking cannot collect the necessary data after making reasonable effort to do so, the undertaking may then need to rely on data from indirect sources, like sector-average data, sample analyses, market and peer groups data, other proxies, etc. For example, for VC workers extracting commodities used as components of the undertaking's products, the undertaking may be able to arrange site audits. However, if those actions to obtain primary data and

information are not possible after reasonable effort, the undertaking may rely on sector or country data estimating those impacts (e.g., negative impacts on safety, health; risk of child labour etc.) in the location of the mining activities.

125. When a reporting entity does not have access to data received directly from VC actors, after making reasonable efforts, it shall estimate the information to be reported using sector data or similar data as a starting point (ESRS 1 paragraph 69). Examples include Scope 3 emissions or living wage data of facilities in very high-risk countries, including beyond the first tier of business relationships.

126. Another example may be around national wages. The WageIndicator provides information about minimum and living wages for more than 200 countries. Undertakings can use this information to explain prioritisation of actions and targets in specific countries or regions for both own workforce and workers in the VC. The information from such sources could form part of its explanation under ESRS 2 SBM-3 of how it identified and assessed material IROs. The exact living wages may differ in certain facilities and are dependent on the composition of the family of a worker, however these sources can be useful in the context of the materiality assessment. Once wage has been identified as a material risk, it can be that more accurate data is needed to set targets and to report on progress. This would for example require more concrete supply chain partner data. However, this could take time. Entities should report on what their process on improving data quality looks like over time (ESRS 2 paragraph 10 (d)).

127. Undertakings need to be aware that setting up a reliable data collection system which includes VC partners takes time. They should consider an investment in technology, as well as clear processes and controls to collect data and report the information. VC actors will also need time to set this up. The quantity and quality of VC information is likely to improve over time, but until then sector data or similar sources can be a good starting point.

128. The origin of the data is important as it may influence the quality of the information provided in the sustainability statement. Undertakings are expected to describe the basis for preparation of their sustainability statement and the resulting level of accuracy, for metrics that have been reported based on estimates due to missing VC data (ESRS 2 paragraph 10).

129. The use of appropriate estimates or proxies is critical for the quality of reported information. Therefore, transparent disclosure and explanation of the use of estimates are essential.

130. ESRS 2 BP-2 paragraph 10 requires preparers to:

a) identify the metrics for which estimates are used;

b) describe the basis for preparation,

c) the resulting level of accuracy and,

d) where applicable, the planned actions to improve the accuracy in the future.

FAQ 10: Is a case of bribery not involving an employee relevant for the reporting entity?

131. Consider a case where Q, an employee at a customer (XYZ) of the reporting undertaking (ABC), was found to have been bribed by S, an employee at one of XYZ's suppliers. In this case, ABC would not have to disclose this under the metrics of ESRS G1-4, as an employee of the reporting undertaking is not involved in the case and as explained in ESRS G1 paragraph 26. However, ABC would consider this information when it considers the risks around corruption and bribery in the sector/geographical area going forward.

4. VC map

132. **The VC map below does not cover disclosures that fall under entity-specific disclosures mandated under ESRS 1 paragraph 11.** It is the responsibility of the undertaking to determine whether entity-specific VC information is required to allow users to understand the undertaking's material IRO's and/or to meet the qualitative characteristics of information per Appendix B of ESRS 1. (Paragraph 65 of ESRS 1)

VC coverage map of Draft Set 1 ESRS

133. This table maps the disclosure requirements in the sector-agnostic ESRS and how these cover the VC.

Level of VC coverage	Disclosure Requirements with this level of VC coverage				
1. The undertaking shall assess its material IROs across its VC	• IRO-1				
2.The undertaking shall describe its material IROs and report where in the VC they arise	• SBM-3				
3.The undertaking shall reflect in its disclosure whether and how processes and policies, actions or targets cover the VC (if they do not cover VC, information is not required)	• BP-1, • BP-2, • SBM-2, • GOV-4 • GOV-5 • E1-2, • E1-3, • E1-4, • E1-9,	• E2-1, • E2-2, • E2-3, • E2-6, • E3-1, • E3-2, • E3-3, • E3-5,	• E4-1, • E4-2, • E4-3, • E4-4, • E4-6, • E5-1, • E5-2, • E5-3, • E5-6,	• S1-1/S1-5 • S2-1/S2-5 • S3-1/S3-5 • S4-1/S4-5	• G1-1, • G1-2, • G1-3
4.The disclosure only reflects own operations, as no coverage of VC is required in this disclosure	• GOV-1, • GOV-2, • GOV-3, • SBM-1	• IRO-2, • E1-5, • E1-8	• E2-4, • E3-4, • E5-4, • E5-5	• S1-1 to S1-17[3]	• G1-4, • G1-5, • G1-6
5. The standard covers policies, actions and targets for IROs that are linked to people in the VC[4] (same as 3 above)	• S2-1, • S2-2, • S2-3,	• S2-4, • S2-5,	• S4-1, • S4-2, • S4-3,	• S4-4, • S4-5	
6.There are specific datapoints in this DR that requires coverage of VC information	• E1-1,	• E1-6	• E1-7,	• E4-5	
7.SFDR indicators[5] listed in	VC to be covered to the extent that foreseen in the relevant technical				

[3] Some consider DR S1-7 as requiring information about the VC however, these employees form part of own workforce.

[4] The standard ESRS S3 – *Affected communities* covers a group of people that may also part of the undertaking's upstream and downstream VC when they also have business relationships with the undertaking.

[5] The SFDR regulation is open for consultation until early July and changes may follow.

Level of VC coverage	Disclosure Requirements with this level of VC coverage
ESRS 2 Appendix C	standards
8.Other EU law (excluding SFDR) in ESRS 2 Appendix C	VC to be covered

The names of the disclosure requirements are provided in Appendix B.

DRs with specific provisions on VC:

DR	Content
BP-1	To what extent the sustainability statement covers the undertaking's upstream and downstream VC.
BP-2	When metrics include VC data estimated using indirect sources, such as sector-average data or other proxies, the undertaking shall: i. identify the metrics; and ii. describe the basis for preparation, the resulting level of accuracy and, where applicable, the planned actions to improve the accuracy in the future.
SBM-3	For each material IRO identified in the materiality assessment, the undertaking shall report whether the undertaking is involved with the negative or positive impact through its activities or because of its business relationships.
E2-5	Relates to the products/materials and/or substances procured which ends up in products / manufacturing.
E4-5	Voluntary to include life cycle approach for material impacts with regards to land-use change or impacts on extent and condition of ecosystems.
E5-4, E5-5	Includes supplied material but does not expand to suppliers
E5-6	Waste treatment may sometimes require information from supplier who treats waste

Appendix A.1: Examples of ESRS *E5 Circular Economy* VC interactions in high-impact sectors

1. This appendix illustrates the possible interactions between actors in the VC in the different steps of the lifecycle of products in high-impact sectors. They support the understanding of the interactions in the value-chain in a perspective of circular economy.

Steel value chain, scope 3 and toxic substances in steel products

2. The steel VC involves several key actors, such as raw material suppliers, steel manufacturers, downstream processors, distributors, end-users, and scrap metal recyclers.

3. Raw material suppliers play a crucial role by providing iron ore, coal, and other inputs needed for steel production. Steel manufacturers then process these raw materials through various methods, such as blast furnaces or electric arc furnaces, to produce different types of steel products. These products can range from structural steel used in construction and infrastructure projects to automotive steel for vehicle manufacturing, stainless steel for kitchenware, or specialty steels for specific applications like aerospace or electrical equipment.

4. After the steel products have served their intended purpose, they enter the recycling phase. Downstream processors and distributors may collect scrap metal from various sources, including end-of-life products, manufacturing waste, or demolition materials. The collected scrap metal is then processed by scrap metal recyclers, who use methods like shredding, sorting, and melting to transform the scrap into reusable steel. This recycled steel, often referred to as secondary steel, can be reintroduced into the steel VC and used to produce a wide range of products.

5. Scope 3 emissions in the steel VC refer to indirect greenhouse gas emissions that occur throughout the entire lifecycle of steel, including activities outside the direct control of steel producers. These emissions encompass the extraction of raw materials, transportation of materials and products, use of steel products by end-users, and the disposal or recycling of steel at the end of its life.

6. Addressing Scope 3 emissions in the steel VC is crucial for achieving sustainable and low-carbon steel production.

7. The use of toxic substances in steel products is a concern that needs to be addressed to ensure the safety and environmental sustainability of the steel VC. While steel itself is not inherently toxic, certain substances may be added during the manufacturing process or found as impurities in the raw materials used for steel production.

8. To mitigate the presence of toxic substances in steel products, several measures can be taken:

   a) Regulatory compliance: governments and regulatory bodies establish standards and regulations to limit the use of toxic substances in steel production. Steel manufacturers must comply with these regulations to ensure the safety of their products.

   b) Material selection: steel producers can carefully select raw materials, such as iron ore and scrap metal, to minimize the presence of toxic elements. Thorough testing and screening of materials can help identify and exclude those with high levels of harmful substances.

   c) Process control: implementing stringent process controls and quality assurance procedures during steel production helps minimize the introduction of toxic substances. This includes monitoring and controlling the composition and chemistry of the steel throughout the manufacturing process.

   d) Substitution and innovation: research and development efforts can focus on finding alternative materials and processes that reduce or eliminate the use of toxic substances. This includes exploring new alloys, coatings, and surface treatments that offer equivalent performance without posing health and environmental risks.

   e) Supply chain transparency: collaboration with suppliers and transparency throughout the supply chain are essential to identify and address potential sources of toxic substances. Steel manufacturers should work closely with their suppliers to ensure the traceability and safety of the materials used in their products, also enabled by digital technologies.

9. By adopting these measures, the steel industry can work towards minimizing or eliminating the presence of toxic substances in steel products. This not only protects human health and the environment but also enhances the sustainability and reputation of the steel VC.

Plastic value chain

10. The circular economy for plastics is an approach that aims to minimize waste and maximize the value of plastic materials by promoting their reuse, recycling, and regeneration. This involves several key actors in the plastic VC:

    a) Raw material suppliers: these companies extract and produce raw materials used in the production of plastics, such as crude oil, natural gas, and petrochemicals. They supply these materials to plastic manufacturers.

    b) Plastic manufacturers: these companies use raw materials to produce different types of plastic products, including packaging materials, consumer goods, automotive parts, etc. Plastic manufacturers may range from large multinational corporations to smaller specialized companies.

    c) Brand owners: these are companies that market and sell products packaged in plastic. They collaborate with plastic manufacturers to develop and produce packaging that represents their brand image. Brand owners have a significant influence on packaging design and material choices, such as for food, beverage, cosmetics, and other industries.

    d) Retailers: these include supermarkets, department stores, and online platforms that sell plastic-packaged products to consumers. They play a crucial role in the distribution and marketing of plastic products.

    e) Consumers: they are the end-users of plastic products. They purchase and use plastic-packaged goods in their daily lives. They have a direct impact on the demand for plastic and can influence sustainable consumption practices.

    f) Waste management companies: these companies are responsible for collecting, sorting, recycling, and disposing of plastic waste. They operate recycling facilities, waste-to-energy plants, and landfill sites. Waste management companies work closely with municipalities and local authorities to manage plastic waste effectively.

11. These actors play different roles in the lifecycle of plastics, including the implementation of Extended Producer Responsibility (EPR) schemes and plastic deposit schemes for consumers.

    a) Extended Producer Responsibility (EPR) is a policy approach that holds manufacturers responsible for the end-of-life management of their products. EPR organizations are typically industry associations or independent entities that administer and enforce EPR programs. They collaborate with producers, retailers, and waste management companies to ensure the proper collection, recycling, and safe disposal of plastic products.

    b) Plastic deposit schemes, also known as bottle deposit schemes or container deposit schemes, encourage consumers to return used plastic containers for recycling by offering a refundable deposit. Under these schemes, consumers pay an additional amount when purchasing a plastic container, which is refunded when they return the empty container to a designated collection point. The returned containers are then collected, sorted, and sent for recycling. These schemes help increase recycling rates and reduce plastic litter in the environment.

12. Governments at various levels (local, regional, and national) play a crucial role in formulating and implementing policies related to plastic waste management. They establish regulations, set recycling targets, and enforce compliance with EPR schemes. Government agencies also work with stakeholders to develop plastic deposit schemes and other initiatives to promote recycling and reduce plastic pollution.

13. Overall, the plastic VC involves a wide range of actors, including raw material suppliers, manufacturers, brand owners, retailers, consumers, waste management companies, EPR organizations, and government bodies. Collaboration and engagement among these stakeholders are vital to promoting sustainable plastic use, recycling, and waste management practices.

Tire value chain

14. The tire VC involves the various stages and actors involved in the production and lifecycle of rubber until its end-of-life management. The VC encompasses the design, manufacturing, distribution, installation, operation, maintenance, end-of-life disposal, and recovery of pneumatic components.

    a) Natural rubber is primarily produced from rubber trees cultivated in plantations. Farmers tap the trees to collect latex, which is then processed into solid rubber. Synthetic rubber is produced from petroleum-based chemicals through a chemical process. Petrochemical companies and polymer manufacturers play a key role in synthesizing rubber compounds.

    b) Tire manufacturers receive natural and synthetic rubber, along with various additives such as carbon black, fillers, and chemicals. Rubber compounders specialize in blending these materials to create customized rubber compounds with desired properties. They employ specialized machinery and processes to mould and assemble the various tire layers, resulting in the production of tires.

    c) Pneumatics are distributed through wholesalers or directly to retailers, including tire dealerships and auto service centres. These entities play a role in storing, selling, and distributing tires to end consumers or vehicle manufacturers.

    d) Vehicle owners and drivers utilize tires for their vehicles, ensuring proper inflation, regular maintenance, and adherence to safety guidelines. Maintenance technicians provide tire services such as mounting, balancing, and alignment.

    e) When tires reach the end of their useful life or are no longer safe for use, they need to be replaced. Vehicle owners or tire retailers are responsible for proper disposal or recycling. Waste management companies handle tire recycling or disposal to ensure environmental compliance.

    f) Pneumatics recycling facilities process used tires to recover materials such as rubber, and steel. Rubber reclaimers transform recycled rubber into granules or crumb rubber for various applications, including manufacturing new tires, rubberized products, or as infills for sports fields.

15. Some entities explore creative ways to upcycle or repurpose used tires, turning them into products like footwear, playground surfaces, road construction materials, or even artistic and decorative items.

16. The rubber in tires VC involves a diverse range of actors, including rubber farmers, chemical manufacturers, tire producers, distributors, retailers, vehicle owners, waste management companies, and recycling facilities. Each actor plays a crucial role in ensuring the production, use, and responsible disposal or repurposing of rubber in tires, contributing to the circularity and sustainability of the industry.

Appendix A.2: Visual examples of VC activities

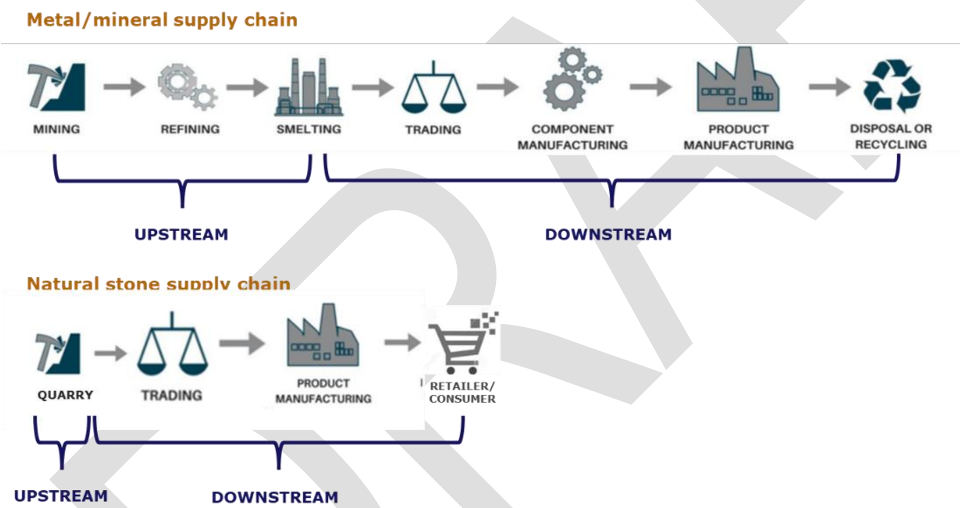
Fishing example:

https://www.leroyseafood.com/globalassets/leroy-seafood/sustainability/sustainability-library-2020/governance-and-stakeholders/value-chain-analysis-sustainability-1.pdf

Chocolate example:

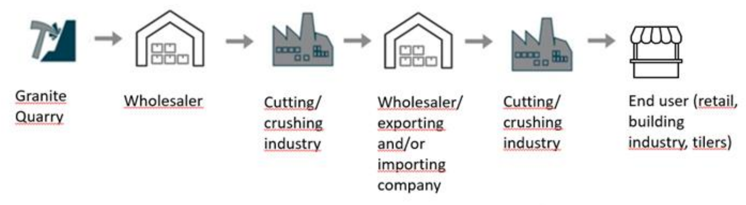
https://kpmg.com/ch/en/home/insights/2022/06/esg-supply-chain.html

Metal/mineral and natural stone examples:



Credit: SER IRBC agreements

Granite example



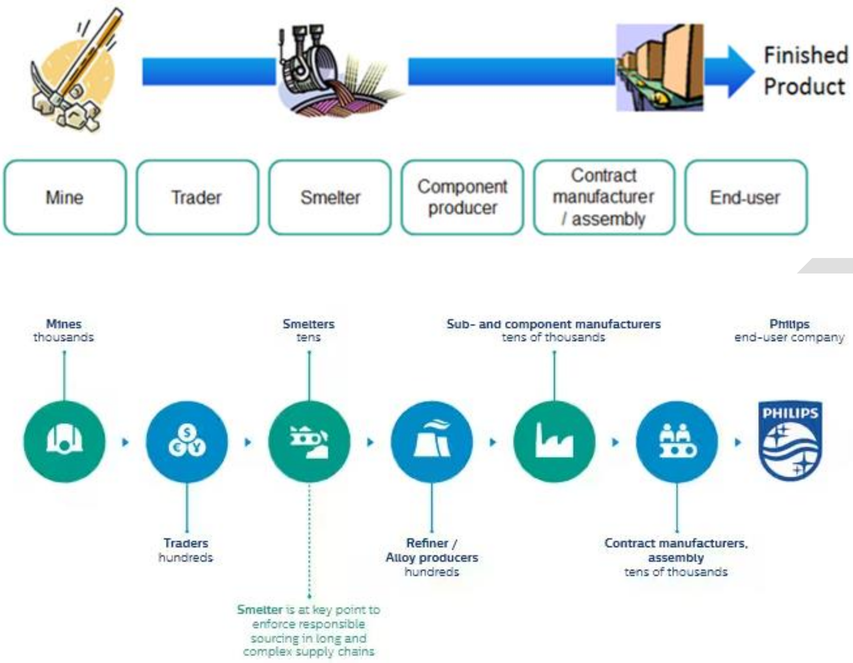
Credit: SER IRBC Truestone agreement

Shea example

Please see: https://www.imvoconvenanten.nl/-media/imvo/files/voedingsmiddelen/factsheet/factsheet-shea.pdf?la=nl&hash=32FA96061D627A8079D2C3313E3EAAC0

Manufacturing (simplified example)

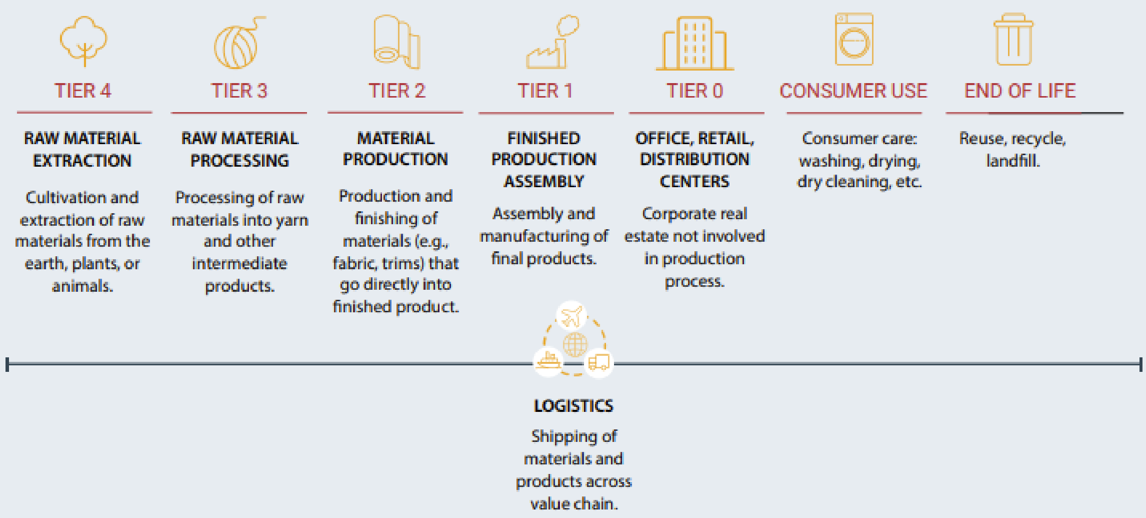
Simplified supply chain for Philips products:



https://www.philips.com/a-w/about/environmental-social-governance/environmental/supplier-sustainability/responsible-sourcing-of-minerals.html

Textile

Figure 4: The tiers in the textile value chain



Source: WRI and Aii (2021). Roadmap to Net Zero: Delivering Science-Based Targets in the Apparel Sector.

Sustainability and circularity in the textile VC (page 21), available here.

Appendix B: Names of disclosure requirements

1. The list of names of the disclosure requirements is to help in the use of the VC map.

ESRS 2 – *General disclosures*
DR 2-BP-1 – General basis for preparation of sustainability statement
DR 2-BP-2 – Disclosures in relation to specific circumstances
DR 2-GOV-1 – The role of the administrative, management and supervisory bodies
DR 2-GOV-2 – Information provided to and sustainability matters addressed by the undertaking's administrative, management and supervisory bodies
DR 2-GOV-3 – Integration of sustainability-related performance in incentive schemes
DR 2-GOV-4 – Statement on due diligence
DR 2-GOV-5 – Risk management and internal controls over sustainability reporting
DR 2-SBM-1 – Strategy, business model and value chain
DR 2-SBM-2 – Interests and views of stakeholders
DR 2-SBM-3 – Material IROs and their interaction with strategy and business model
DR 2-IRO-1 – Description of the processes to identify and assess material IROs
DR 2-IRO-2 – Disclosure Requirements in ESRS covered by the undertaking's sustainability statement
Policies MDR-P – Policies adopted to manage material sustainability matters
Actions MDR-A – Actions and resources in relation to material sustainability matters
Metrics MDR-M – Metrics in relation to sustainability matters
Targets MDR-T – Tracking effectiveness of policies and actions through targets

ESRS E1- *Climate change*
DR E1-1 – Transition plan for climate change mitigation
DR E1-2 – Policies related to change mitigation and adaptation
DR E1-3 – Actions and resources in relation to climate change policies
DR E1-4 – Targets related to climate change mitigation and adaptation
DR E1-5 – Energy consumption and mix
DR E1-6 – Gross Scopes 1, 2, 3 and Total GHG emissions
DR E1-7 – GHG removals and GHG mitigation projects financed through carbon credits
DR E1-8 – Internal carbon pricing
DR E1-9 – Anticipated financial effects from material physical and transition risks and potential climate-related opportunities

ESRS E2 - *Pollution*
DR E2-1 – Policies related to pollution
DR E2-2 – Actions and resources related to pollution
DR E2-3 – Targets related to pollution
DR E2-4 – Pollution of air, water and soil
DR E2-5 – Substances of concern and substances of very high concern
DR E2-5 – Anticipated financial effects from pollution-related IROs

ESRS E3 - *Water and marine resources*
DR E3-1 – Policies related to water and marine resources
DR E3-2 – Actions and resources related to water and marine resources
DR E3-3 – Targets related to water and marine resources
DR E3-4 – Water consumption
DR E3-5 – Anticipated financial effects from water and marine resources-related IROs

ESRS E4 - *Biodiversity and ecosystems*
DR E4-1 –Transition plan and consideration of biodiversity and ecosystems in strategy and business model
DR E4-2 – Policies related to biodiversity and ecosystems
DR E4-3 – Actions and resources related to biodiversity and ecosystems
DR E4-4 – Targets related to biodiversity and ecosystems
DR E4-5 – Impact metrics related to biodiversity and ecosystems change
DR E4-6 – Anticipated financial effects from biodiversity and ecosystem-related IROs

ESRS E5 - *Resource use and circular economy*
DR E5-1 – Policies related to resource use and circular economy
DR E5-2 – Actions and resources related to resource use and circular economy
DR E5-3 – Targets related to resource use and circular economy

ESRS E5 - ***Resource use and circular economy***
DR E5-4 – Resource inflows
DR E5-5 – Resource outflows
DR E5-6 – Anticipated financial effects from material resource use and circular economy-related IROs

ESRS S1 - ***Own workforce***
DR S1-1 – Policies related to own workforce
DR S1-2 – Processes for engaging with own workforce and workers' representatives about impacts
DR S1-3 – Processes to remediate negative impacts and channels for own workforce to raise concerns
DR S1-4 – Taking action on material impacts on own workforce, and approaches to mitigating material risks and pursuing material opportunities related to own workforce, and effectiveness of those actions
DR S1-5 – Targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities
DR S1-6 – Characteristics of the undertaking's employees
DR S1-7 – Characteristics of non-employee workers in the undertaking's own workforce
DR S1-8 – Collective bargaining coverage and social dialogue
DR S1-9 – Diversity metrics
DR S1-10 – Adequate wages
DR S1-11 – Social protection
DR S1-12 – Persons with disabilities
DR S1-13 – Training and skills development metrics
DR S1-14 – Health and safety metrics
DR S1-15 – Work-life balance metrics
DR S1-16 – Compensation metrics (pay gap and total compensation)
DR S1-17 – Incidents, complaints and severe human rights impacts

ESRS S2 - ***Workers in the value chain***
DR S2-1 – Policies related to value chain workers
DR S2-2 – Processes for engaging with value chain workers about impacts
DR S2-3 – Processes to remediate negative impacts and channels for value chain workers to raise concerns
DR S2-4 – Taking action on material impacts on value chain workers, and approaches to managing material risks and pursuing material opportunities related to value chain workers, and effectiveness of those actions
DR S2-5 – Targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities

ESRS S3 - ***Affected communities***
DR S3-1 – Policies related to affected communities
DR S3-2 – Processes for engaging with affected communities about impacts
DR S3-3 – Processes to remediate negative impacts and channels for affected communities to raise concerns
DR S3-4 – Taking action on material impacts on affected communities, and approaches to managing material risks and pursuing material opportunities related to affected communities, and effectiveness of those actions
DR S3-5 – Targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities

ESRS S4 - ***Consumers and end-users***
DR S4-1 – Policies related to consumers and end-users
DR S4-2 – Processes for engaging with consumers and end-users about impacts
DR S4-3 – Processes to remediate negative impacts and channels for consumers and end-users to raise concerns
DR S4-4 – Taking action on material impacts on consumers and end-users and approaches to managing material risks and pursuing material opportunities related to consumers and end-users, and effectiveness of those actions
DR S4-5 – Targets related to managing material negative impacts, advancing positive impacts, and managing material risks and opportunities

ESRS G1 - ***Business conduct***
DR G1-1 – Business conduct policies and corporate culture
DR G1-2 – Management of relationships with suppliers
DR G1-3 – Procedures to address corruption or bribery
DR G1-4 – Incidents of corruption or bribery
DR G1-5 – Political influence and lobbying activities
DR G1-6 – Payment practices