EFRAG

sustainability reporting

FEEDBACK STATEMENT

EFRAG IG 2

Value chain

Disclaimer

This Feedback Statement has been prepared by the EFRAG Secretariat to summarise the main comments received by EFRAG on its draft implementation guidance and explain how those comments were considered by EFRAG during its technical discussions leading to the publication of its implementation guidance.

The content of this Feedback Statement does not constitute any form of authoritative material, advice or opinion and does not represent the official views of EFRAG or any individual member of the EFRAG SRB or EFRAG SR TEG.

About EFRAG

EFRAG's mission is to serve the European public interest in both financial and sustainability reporting by developing and promoting European views in the field of corporate reporting. EFRAG builds on and contributes to progress in corporate reporting. In its sustainability reporting activities, EFRAG provides technical advice to the European Commission in the form of draft European Sustainability Reporting Standards (ESRS) elaborated under a robust due process and supports the effective implementation of ESRS. EFRAG seeks input from all stakeholders and obtains evidence about specific European circumstances throughout the standard- setting process. Its legitimacy is built on excellence, transparency, governance, due process, public accountability and thought leadership. This enables EFRAG to speak convincingly, clearly, and consistently, and to be recognised as the European voice in corporate reporting and a contributor to global progress in corporate reporting.

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Introduction

Objective of this feedback statement

The objective of this Feedback Statement is to indicate how the comments received in the public feedback and the subsequent discussions in EFRAG SR TEG and EFRAG SRB meetings led to the final version of the ESRS Implementation Guidance number 2 *Value Chain* (IG 2). This feedback statement addresses how EFRAG has implemented changes to the implementation guidance following the public's concerns and suggestions and the reasons for implementing those changes. Moreover, the objective of this feedback statement is to highlight the main differences between the draft IG 2 and the final version of the IG 2.

Background

On 22 December 2023, EFRAG published its first three draft ESRS Implementation Guidance documents, with a deadline for public feedback set to 2 February 2024. The documents are non-authoritative and support the implementation of ESRS. IG 2 describes the reporting requirements on value chain about the materiality statement, material impacts, risks and opportunity management as well as metrics and targets. It discusses the reporting boundary of the undertaking for sustainability reporting, including the role of operational control in environmental metrics. IG 2 also contains a section with FAQs to provide further information as well as a 'value chain map' illustrating where information is required at the level of disclosure requirement in the ESRS value chain (VC).

General overview of comments received from respondents

EFRAG received and considered 68 submissions to the online survey and eight comment letters from respondents. These comment letters are available on EFRAG's website. For more details on the public feedback, please refer to Paper 07-02 of the EFRAG SRB meeting on 20 March 2024.

The comment letters received came from national standard-setters, business associations, NGOs, preparers, users and assurance providers.

The following points summarise the main concerns, issues and ideas collected from the respondent's comment letters:

- a need for alignment between ESRS and future CSDDD
- entity-specific disclosures and transitional provisions
- operational control and alignment with the GHG Protocol
- operational control – financial reporting concepts
- operational control – ESRS Social Standards
- additional examples
- reasonable effort
- editorial and miscellaneous comments.

In the public consultation, respondents noted that IG 2 should be consistent with ESRS in terms of content and language, including definitions (such as the definition of value chain).

EFRAG's final Implementation Guidance

The final IG 2 considered and implemented all the appropriate editorial changes and suggestions from the public feedback that enhanced the readability and understandability of the document. The wording was aligned with the changes made to relevant paragraphs in IG 1 Materiality Assessment following the public feedback. These changes are not addressed in this document.

This section addresses the main comments received in the public feedback which led to changes in the IG 2, paying particular attention to the concept of operational control, the reporting perimeter for ESRS E1, financial reporting concepts, as well as the additional examples added to the final version of IG 2 with the objective of illustrating in practical terms the aforementioned concepts.

Alignment between the CSDDD and ESRS

Respondents' comments

Several respondents recommended EFRAG to ensure coherence in terms of value chain coverage regarding the current applicable due diligence legislation and the CSDDD. The CSDDD limits the downstream disclosures with the notion of 'chain of activity', excluding customers and the sale or use of the product. Some respondents noted that, until the CSDDD is finalised and there are no consistent, level-playing field requirements on due diligence, the IG 2 should not build on the assumption that due diligence requirements are legally binding at the European level.

EFRAG's final position and decision

This guidance cannot deviate from the content of the ESRS issued as Delegated Act, which is aligned with the CSRD, the international instruments of due diligence and the GRI. EFRAG concluded that IG 2 is based on the CSRD and not the CSDDD. Any possible changes following the finalisation of the CSDDD will also have to consider alignment with international instruments of due diligence (OECD, UNGP) and the GRI's impact materiality definition. The CSDDD focuses on behavioural aspects while the CSRD and ESRS focus on reporting. Therefore, changes in obligations do not necessarily change the reporting requirements under the CSRD/ESRS. Preparers need to be transparent about what they do in their entire value chain.

This was relayed in a caveat in IG 2.

Reference in the final IG 2

Introduction, page 6, box

Entity-specific disclosures and transitional provisions

Respondents' comments

Regarding entity-specific disclosures, respondents indicated that IG 2 needs to be clearer. Moreover, there were requests to address in the IG 2 whether entity-specific metrics are also required for VC disclosures.

In the public feedback, respondents argued that the IG 2 should not refer to ESRS 1 paragraph 11, ESRS 1 AR 1 to AR 5 or ESRS 1 paragraph 65 in support of the statement that an undertaking is required to provide entity-specific VC metrics when, according to the outcome of its materiality assessment, this is necessary from an entity-specific perspective.

EFRAG's final position and decision

The final guidance clarifies that the inclusion of entity-specific information, including metrics, is a requirement and not optional when conditions in ESRS paragraph 11 are met. The guidance also clarifies that these metrics are not standardised but are defined by the undertaking.

EFRAG decided to clarify certain aspects of references to entity-specific disclosures. The final version of IG 2 includes clarification regarding entity-specific disclosures during the period of transitional provisions, stating that the provision of entity-specific disclosures under ESRS 1 paragraph 11 is mandatory in the first three annual sustainability statements.

Reference in the final IG 2

Page 9, paragraph 21 d

Page 23, paragraphs 90 and 91.

Operational control - Accounting for GHG emissions

Respondents' comments

Several respondents pointed out that there was no alignment in the draft IG 2 between the GHG Protocol (GHGP) and ESRS in terms of accounting for GHG emissions. Furthermore, it was pointed out that paragraphs 40 and 53 (Reporting boundary decision three) of the draft IG 2 contradicted the GHG Protocol directly.

Respondents asked for clarification on whether the undertaking still has operational control in case of missing the unilateral power to impose an investment on the partners of a joint venture while retaining the power to impose the operating policies on them.

EFRAG's final position and decision

The compatibility of ESRS with the GHG Protocol has been clarified: the GHG Protocol provides different options. ESRS E1 adopts a financial control approach, which is one of the possible approaches of the GHGP, and the datapoint in ESRS E1 paragraph 50(a) corresponds to the amount of Scope 1 and Scope 2 emissions under the GHGP's financial control approach. However, ESRS E1 requires adding to this amount the GHG emissions of sites, assets and entities under operational control that are not included in the financial statements (datapoint in ESRS E1 paragraph 50(b)).

The reporting boundary decision three was amended and refocused on environmental metrics only (where operational control applies, i.e., E1 and E2, in addition to E4 for narrative disclosure of lists of sites). Following the comments received on GHG Accounting under operational control and its interoperability with the GHG Protocol, the final IG 2 includes two new illustrative FAQs:

- FAQ 6 is an example to show how GHG emissions are reported under the GHG Protocol and the ESRS under different accounting classifications; and
- FAQ 7 illustrates differences in the treatment of GHG emissions either as subsidiary, as an actor in the value chain or as an investment only.

The approach of the guidance is that operational control is broader than having the power to govern/impose investments on GHG-reducing technologies. The guidance agrees with including clarification that DRs on targets will reflect the targets of the reporting undertaking (e.g., targets may exclude GHG emissions over which the undertaking does not have the power to impose investments needed to reduce GHG emissions).

Reference in the final IG 2

Chapter 2.3

Pages 33 to 37, FAQ 6: *Reporting perimeter for ESRS E1 in practice*

Page 38, FAQ 7: *Numerical example of GHG emissions under ESRS E1 reporting.*

Operational control - Financial reporting concepts

Respondents' comments

The public consultation revealed that there was some uncertainty regarding financial reporting concepts surrounding financial control and operational control. In this regard, the draft IG 2 did not explicitly address accounting principles, nor did it clarify whether these concepts could be extrapolated to sustainability reporting. There were many comments stressing uncertainty around the treatment of joint arrangements, associates and unconsolidated subsidiaries.

EFRAG's final position and decision

EFRAG noted that it is important to clarify that joint control, operational control and significant influence are financial reporting concepts not covered in the ESRS.

The final version of IG 2 includes a new section elaborating on several concepts that apply to financial reporting. That section is designed for those with a financial reporting background who seek to relate financial reporting concepts to the sustainability statement.

EFRAG decided to include a new FAQ 5 to illustrate, with the aid of a table, the treatment of impacts arising from the undertaking's investments by their accounting treatment in financial statements.

Reference in the final IG 2

Page 13, paragraphs 37 to 39

Page 31 and 32, FAQ 5: *How are investees treated under ESRS E1?*

Operational control – ESRS Social standards

Respondents' comments

In the public consultation, respondents indicated that the concept of operational control should not be applied by analogy with social standards, as mentioned in the draft IG 2.

EFRAG's final position and decision

IG 2 includes an explanation of the applicability of the operational control concept to ESRS S1 and S2. IG 2 establishes that for S1 and S2 the notion of operational control is based on the arrangements of contractual relationships between the workers and the reporting undertaking. Moreover, it is clearly stated in IG 2 that the concept of operational control does not apply to social standards.

Reference in the final IG 2

Page 18, paragraphs 60 and 61.

Additional examples

Respondents' comments

In the public consultation, respondents indicated that IG 2 could use more illustrative examples to better explain some of the concepts being addressed.

EFRAG's final position and decision

To this end, a new example related to E1 metrics and accounting for GHG emissions has been added.

FAQ 6 specifically shows how to interpret the reporting perimeter under ESRS E1 when several subsidiaries, joint arrangements and associates are involved. EFRAG decided to include this FAQ to explain the concept of operational control according to different levels of investment.

FAQ 7 is a numerical example showing how to account for GHG emissions under ESRS E1 reporting. It illustrates three different scenarios: first, a scenario where Company B is a subsidiary of Company A; second, a scenario where company A buys supplies from B (emissions from purchased goods); and third, a scenario where A holds ownership share in company B (emissions from investments).

Reference in the final IG 2

Pages 33 to 37, FAQ 6: *Reporting perimeter for ESRS E1 in practice*

Page 38, FAQ 7: *Numerical example of GHG emissions under ESRS E1 reporting.*

Reasonable effort

Respondents' comments

Respondents requested more guidance on what 'reasonable effort' means when determining whether it is necessary to obtain direct information from actors in the value chain as opposed to developing estimates of information about their value chain by using proxies.

EFRAG's final position and decision

Providing additional guidance would constitute interpretation of the concept of 'reasonable effort', but this is not something that can be done through implementation guidance.