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This is the same paper as discussed at the 17 October SR TEG meeting. The outcome of that discussion will be verbally presented in the SRB meeting.

Feedback on VCIG Issues Paper

Objective

1. The objective of this session is to obtain inputs from SRB about feedback received from SRB and SR TEG members on the VCIG draft. The intention is to agree the wording for certain topics before amending the guidance.

Description of VC aspects related to PAT

2. The VCIG is re-stating the requirements around policies, actions and targets in as far as these cover the value chain.
3. However, based on the comments received from an SR TEG member, it seems that the drafting is not read in this way.
4. The relevant paragraphs are: 5, 11 (d) first sentence, 94. These and other paragraphs reference the numbers in the 5 September 2023 document. The numbers have changed in the updated document.

EFRAG Secretariat proposal

5. The EFRAG Secretariat agrees that the current wording (*all the topical standards require undertakings to cover the VC in the disclosures about policies, actions and targets for material IROs*) could be unintentionally misleading. Therefore, the Secretariat proposes using the following wording or close to it throughout:
   a. Topical ESRS require to disclose the policies, actions and targets that the undertaking has in place. Therefore, where a policy, action or target involves all or some VC actors, the disclosure shall include VC information. The minimum disclosure requirements in ESRS 2 paragraphs 65(b), 68(b) and 71(b) requires disclosure about the scope of the policies, actions and targets and refers to VC.
   b. As a reminder, the undertaking can comply by disclosing that it has not adopted policies, actions and targets 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 paragraphs 62 and 72).

Linkage between ESRS 1 paragraph 11 and 65

6. The VCIG links the requirements in the two paragraphs by saying that as ESRS 1 paragraph 11 requires entity-specific information in certain cases, and paragraph 65 requires VC information in certain cases, entity-specific information may require VC information.
7. An SR TEG member considers that entity-specific information is voluntary and also disagrees with this linkage. The arguments are the following:

a. Entity-specific metric is not standardised metrics as ESRS 1 paragraph 11 does not mention metrics but only information and aims at own operations.
b. ESRS does not require quantitative indicators for the VC where no direct quantitative data collection is needed (use of proxies and sector averages for example). This is also relevant to the datapoints in EU legislation.
c. Entity-specific metrics are 'may', not 'shall' in reference to the mention of entity-specific disclosures in paragraph 100.
d. Other EU law does not require VC to be covered.

8. The relevant or impacted paragraphs are: 7, 11(b) last sentence as well as (f), 35, 41, 100, 102, 105, 111 and VC map.

EFRAG Secretariat analysis

9. When looking at the ESRS requirements for entity specific requirements, the EFRAG Secretariat notes that ESRS 1 paragraph 11 refers to disclosures (which is broader than 'information') rather than information and that AR 3 covers specifically the usefulness or not of metrics specifically. Furthermore, entity-specific information is required by ESRS and not voluntary.
10. The EFRAG Secretariat disagrees with the interpretation that paragraphs 63 to 66 refer only to qualitative information and not to quantitative metrics. Paragraph 63 refers to the sustainability statement of the undertaking as a whole using the word 'information' and that it should be extended to include the VC in certain circumstances.
11. The EFRAG Secretariat also notes that value chain information is defined in paragraph 63 as: '*information on the material impacts, risks and opportunities connected with the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain*' is not limited to the disclosure about IROs disclosed under SBM 3, but it includes all the disclosures (e.g. SBM 3, topical PAT, topical metrics).
12. Paragraph 63 also does not exclude the possibility for reporting undertakings to determine that on an entity specific basis the standardised metrics should be extended to include information from the VC.
13. The EFRAG Secretariat acknowledges that including VC quantitative and qualitative information is challenging, and this is the reason for the transitional provision in this area. The Secretariat also acknowledges that the quality of characteristics must be met before information is included. Therefore, reliability of the information has to be evaluated before inclusion. Also, important to note that the standards accept that a level of inaccuracy may exist such as when value chain data are missing as paragraph 11 of ESRS 2 requires disclosing the resulting level of accuracy.
14. The EFRAG Secretariat also notes in paragraph 133(b) refers to metrics but excludes datapoints derived from other EU legislation per ESRS 2 Appendix B.
15. Therefore, the EFRAG Secretariat considers it inappropriate to update these paragraphs in the guidance as inconsistent with the ESRS, except to update incorrect references to ESRS 2 Appendix B in the value chain map.

Reliability of information

16. An SRB member provided comments on the guidance and suggested additional wording that the EFRAG Secretariat has summarised as follows:
    a. "However, reporting metrics on severe negative impacts cannot be done in this case due to unreliability of data and the information would not meet the quality characteristics of information." As an addition to paragraph 115.

b. "If the undertaking has concerns about the reliability of data from its supply chain partners, it could report on percentage of workers in the particular segment of the VC where it can guarantee that living wage is paid, because it has ringfenced the wages in the contracts with suppliers and it has established effective check mechanism (including engagement with affected stakeholders)." As an addition to paragraph 126.

17. The relevant or impacted paragraphs are: 115 and 126.

EFRAG Secretariat analysis

18. The EFRAG Secretariat notes that QC9 in Appendix B of ESRS 1 states that information can be accurate without being perfectly precise and refers to the processes and controls implemented to avoid material errors or misstatements.
19. Furthermore, paragraph 10 in ESRS 2 requires a description of the level of accuracy for indirect sources of information.
20. The drafting proposals here are based on the concern that for negative material impacts VC actors have an incentive not to provide the full picture and therefore the undertaking cannot use direct data from such VC actors.
21. The EFRAG Secretariat concurs that preparers should be aware of limitations of information from direct sources as highlighted but disagrees with the notion that the undertaking then does not report such metrics in the context of ESRS as a whole.

Ringfencing to level 1

22. An SRB member also proposed to add an example to paragraph 102 as follows: "The percentage of workers in the high-risk segment of the value chain for whom living wages have been achieved" with the comment that "in practice this is done by ringfencing of wages with Tier 1 suppliers and effective due diligence".
23. The relevant or impacted paragraphs are: 102.

EFRAG Secretariat analysis

24. The EFRAG Secretariat did not include this guidance to avoid the impression that obtaining information about direct contractual partners is sufficient to meet the requirements in ESRS. Depending on the location of the IROs in the VC this may be appropriate, but not necessarily as a general rule.

Questions for EFRAG SRB

25. Do EFRAG SRB members agree with the Secretariat proposal in paragraph 5?
26. Do EFRAG SRB members agree with the EFRAG Secretariat analysis about VC and entity-specific disclosures as set out in paragraphs 9 to 15?
27. Does EFRAG SRB agree with the EFRAG Secretariat analysis as set out in paragraphs 18 to 21?
28. Does EFRAG SRB agree with the EFRAG Secretariat analysis as set out in paragraph 24?

Appendix 1: Extracts from ESRS 1

Introduction

1. This appendix provides extracts of the relevant paragraphs from ESRS 1 for ease of reference.

Entity-specific disclosures – paragraph 11

11. In addition to the disclosure requirements laid down in the three categories of ESRS, when an undertaking concludes that an impact, risk or opportunity is not covered or not covered with sufficient granularity by an ESRS but is material due to its specific facts and circumstances, it shall provide additional entity-specific disclosures to enable users to understand the undertaking's sustainability-related impacts, risks or opportunities. Application requirements AR 1 to AR 5 provide further guidance regarding entity-specific disclosures.

Entity specific disclosures in Appendix A

AR 1. The entity-specific disclosures shall enable users to understand the undertaking's impacts, risks and opportunities in relation to environmental, social or governance matters.

AR 2. When developing entity-specific disclosures, the undertaking shall ensure that:

(a) the disclosures meet the qualitative characteristics of information as set out in chapter 2 Qualitative characteristics of information; and

(b) its disclosures include, where applicable, all material information related to the reporting areas of governance; strategy; impact, risk and opportunity management; and metrics and targets (see ESRS 2 chapters 2 to 5).

AR 3. When determining the usefulness of metrics for inclusion in its entity-specific disclosures, the undertaking shall consider whether:

(a) its chosen performance metrics provide insight into:

i. how effective its practices are in reducing negative outcomes and/or increasing positive outcomes for people and the environment (for impacts); and/or

ii. the likelihood that its practices result in financial effects on the undertaking (for risks and opportunities);

(b) the measured outcomes are sufficiently reliable, meaning that they do not involve an excessive number of assumptions and unknowns that would render the metrics too arbitrary to provide a faithful representation; and

(c) it has provided sufficient contextual information to interpret performance metrics appropriately, and whether variations in such contextual information may impact the comparability of the metrics over time.

AR 4. When developing its entity-specific disclosures, the undertaking shall carefully consider:

(a) comparability between undertakings, while still ensuring relevance of the information provided, recognising that comparability may be limited for entity- specific disclosures. The undertaking shall consider whether the available and relevant frameworks, initiatives, reporting standards and benchmarks (such as technical material issued by the International Sustainability Standards Board or the Global Reporting Initiative) provide elements that can support comparability to the maximum extent possible; and

(b) comparability over time: consistency of methodologies and disclosures is a key factor for achieving comparability over time.

AR 5. Further guidance for developing entity-specific disclosures can be found by considering the information required under topical ESRS that addresses similar sustainability matters.

5.1 Reporting undertaking and value chain

62. The ***sustainability statement*** shall be for the same reporting undertaking as the financial statements. For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, the sustainability statement will be for the group. This requirement does not apply where the reporting undertaking is not required to draw-up financial statements or where the reporting undertaking is preparing consolidated sustainability reporting pursuant to Article 48i of Directive 2013/34/EU.

63. The information about the reporting undertaking provided in the ***sustainability statement*** shall be extended to include information on the material ***impacts, risks*** and ***opportunities*** connected with the undertaking through its direct and indirect ***business relationships*** in the upstream and/or downstream ***value chain*** ("value chain information"). In extending the information about the reporting undertaking, the undertaking shall include material impacts, risks and opportunities connected with its upstream and downstream value chain:

(a) following the outcome of its due diligence process and of its ***materiality*** assessment; and

(b) in accordance with any specific requirements related to the value chain in other ESRS.

64. Paragraph 63 does not require information on each and every ***actor in the value chain***, but only the inclusion of material upstream and downstream ***value chain*** information. Different ***sustainability matters*** can be material in relation to different parts of the undertaking's upstream and downstream value chain. The information shall be extended to include value chain information only in relation to the parts of the value chain for which the matter is material.

65. The undertaking shall include material ***value chain*** information when this is necessary to:

(a) allow users of ***sustainability statements*** to understand the undertaking's material ***impacts, risks*** and ***opportunities***; and/or

(b) produce a set of information that meets the qualitative characteristics of information (see Appendix B of this Standard).

66. When determining at which level within its own operations and its upstream and downstream value chain a material sustainability matter arises, the undertaking shall use its assessment of ***impacts, risks*** and ***opportunities*** following the ***double materiality*** principle (see chapter 3 of this Standard).

67. When associates or joint ventures, accounted for under the equity method or proportionally consolidated in the financial statements, are part of the undertaking's value chain, for example as suppliers, the undertaking shall include information related to those associates or joint ventures in accordance with paragraph 63 consistent with the approach adopted for the other ***business relationships*** in the value chain. In this case, when determining impact ***metrics***, the data of the associate or joint venture are not limited to the share of equity held, but shall be taken into account on the basis of the impacts that are connected with the undertaking's products and services through its business relationships.

Estimation using sector averages and proxies in Appendix A

AR 17. When the undertaking cannot collect upstream and downstream ***value chain*** information as required by paragraph 63 after making reasonable efforts to do so, it shall estimate the information to be reported using all reasonable and supportable information that is available to the undertaking at the reporting date without undue cost or effort. This includes, but is not limited to, internal and external information, such as data from indirect sources, sector-average data, sample analyses, market and peer groups data, other proxies or spend-based data.

10.2 Transitional provision related to chapter 5 Value chain

132. For the first 3 years of the undertaking's sustainability reporting under the ESRS, in the event that not all the necessary information regarding its upstream and downstream ***value chain*** is available, the undertaking shall explain the efforts made to obtain the necessary information about its upstream and downstream value chain, the reasons why not all of the necessary information could be obtained, and its plans to obtain the necessary information in the future.

133. For the first 3 years of its sustainability reporting under the ESRS, in order to take account of the difficulties that undertakings may encounter in gathering information from actors throughout their ***value chain*** and in order to limit the burden for SMEs in the value chain:

(a) when disclosing information on ***policies, actions*** and ***targets*** in accordance with ESRS2 and other ESRS, the undertaking may limit upstream and downstream value chain information to information available in-house, such as data already available to the undertaking and publicly available information; and

(b) when disclosing ***metrics***, the undertaking is not required to include upstream and downstream value chain information, except for datapoints derived from other EU legislation, as listed in ESRS 2 Appendix B.

134. Paragraphs 132 and 133 apply irrespective of whether or not the relevant ***actor in the value chain*** is an SME.

135. Starting from the fourth year of its reporting under the ESRS, the undertaking shall include upstream and/or downstream ***value chain*** information according to paragraph 63. In this context, the information required by ESRS to be obtained from SME undertakings in the undertaking's upstream and/or downstream value chain will not exceed the content of the future ESRS for listed SMEs.

2. Qualitative characteristics of information

19. When preparing its ***sustainability statement***, the undertaking shall apply:

(a) the fundamental qualitative characteristics of information, i.e. relevance and faithful representation; and

(b) the enhancing qualitative characteristics of information, i.e. comparability, verifiability and understandability.

Faithful representation

QC 9. Information can be accurate without being perfectly precise in all respects. Accurate information implies that the undertaking has implemented adequate processes and internal controls to avoid material errors or material misstatements. As such, estimates shall be presented with a clear emphasis on their possible limitations and associated uncertainty (see section 7.2 of this Standard). The amount of precision needed and attainable, and the factors that make information accurate, depend on the nature of the information and the nature of the matters it addresses. For example, accuracy requires that:

(a) factual information is free from material error;

(b) descriptions are precise;

(c) estimates, approximations and forecasts are clearly identified as such;

(d) no material errors have been made in selecting and applying an appropriate process for developing an estimate, approximation or forecast, and the inputs to that process are reasonable and supportable;

(e) assertions are reasonable and based on information of sufficient quality and quantity; and

(f) information about judgements about the future faithfully reflects both those judgements and the information on which they are based.

Verifiability

QC 13. Verifiability helps to give users confidence that information is complete, neutral and accurate. Sustainability information is verifiable if it is possible to corroborate the information itself or the inputs used to derive it.

QC 14. Verifiability means that various knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Sustainability information shall be provided in a way that enhances its verifiability, for example:

(a) including information that can be corroborated by comparing it with other information available to users about the undertaking's business, about other businesses or about the external environment;

(b) providing information about inputs and methods of calculation used to produce estimates or approximations; and

(c) providing information reviewed and agreed by the ***administrative, management and supervisory bodies*** or their committees.

QC 15. Some sustainability information will be in the form of explanations or forward-looking information. Those disclosures can be supportable by faithfully representing on a factual basis for example the strategies, plans and risk analyses of the undertaking. To help users decide whether to use such information, the undertaking shall describe the underlying assumptions and methods of producing the information, as well as other factors that provide evidence that it reflects the actual plans or decisions made by the undertaking.

Appendix 2: Extracts from ESRS 2

Introduction

1. Similarly, this appendix provides extracts of the relevant paragraphs from ESRS 2 for ease of reference.

Value chain estimation – paragraph 10 in BP-2

10. When ***metrics*** include upstream and/or downstream ***value chain*** data estimated using indirect sources, such as sector-average data or other proxies, the undertaking shall:

(a) identify the metrics;

(b) describe the basis for preparation;

(c) describe the resulting level of accuracy; and

(d) where applicable, describe the planned ***actions*** to improve the accuracy in the future (see ESRS 1 chapter 5 Value chain).