This draft has not yet been subject to the English editorial review, which will be performed in the version approved by EFRAG SR TEG when submitted to EFRAG SRB.

Log of draft explanations

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Cross-Cutting

ID 496, 513, 595, and 650 – Own operation; fact pattern in different sectors

Category

Cross-cutting, environment

Question asked

How should ‘own operations’ be understood in the case of different industry fact pattern, e.g. in the case of a construction company (general contractor) or a distributor/retailer?

ESRS Reference

ESRS 1 paragraphs 43, 48, 53, 62, 63 and 66; ESRS E5 Disclosure Requirement E5-5, paragraph 31 and 37; Defined terms: operational control

Key terms

Own Operation, value chain, operational control

Background

Several questions with the above ID numbers were received regarding 'own operation'. They relate to different industries. They were bundled as it was considered appropriate to answer the 'own operation' issue more on a principle-based and sector-agnostic basis, instead of for each industry separately. The other questions received were as follows:

(a) ID 513 regarding all ESRS: 'The CSRD makes a distinction between activities in 'own operations' and activities in the 'upstream and downstream value chain'. What determines however whether an activity should be considered as an 'own activity' or not? The question is specifically around subcontracting. A subcontractor is a supplier. When company A subcontracts a piece of work to company B. Should the activities performed by company B then also be considered as 'own operations' by company A?'

(b) ID 496 relating to ESRS E5 Disclosure Requirement E5-5 – *Resource outflows*: 'How should "own operations" be understood in the case of a construction company (general contractor)?

The background provided by the submitter stated: 'Most activities occurring on construction sites are carried out by subcontractors, with the general contractor managing the construction as well as procuring the subcontractors. Most of the C&D waste produced on construction sites therefore originates from the subcontractors carrying out their duties, rather than from employees under the direct control of the reporting entity (in this case general contractor). On construction sites, the general contractor's waste consists mostly of small amounts of office waste.'

(c) ID 595 relating to ESRS E5 Disclosure Requirement E5-5 – *Resource outflows*: 'When performing a demolition of a building for a client, the reporting undertaking is "waste producer" by law. Do these waste amounts have to be reported even though they are not generated in own operations?'

(d) ID 650 regarding ESRS E5 Disclosure Requirement E5-4 – *Resource inflows*: 'Does the disclosure requirement and the datapoints apply to trading companies which do not manufacture goods but only resell them?'

(e) ID 651 regarding ESRS E5 Disclosure Requirement E5-4 – *Resource inflows*: 'Does the disclosure requirement and the datapoints apply to trading companies which act as distributors (in German: Inverkehrbringer) of their own brands? If so, does this disclosure requirement only apply to own-brand products or to all products?'

ESRS do not define an undertaking's 'own operation'.

ESRS 1 paragraph 43 states: 'Impacts include those connected with the undertaking's **own operations** and upstream and downstream value chain, including through its products and services, as well as through its business relationships. Business relationships include those in the undertaking's upstream and downstream value chain and are not limited to direct contractual relationships.'

ESRS 1 paragraph 62 provides that the sustainability statement shall be prepared for the same reporting undertaking as the financial statements (financial control).

ESRS 1 paragraph 63 states: '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").'

ESRS 1 paragraph 66 states: '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.'

ESRS 2 paragraph 48 states: 'The undertaking shall disclose:

(a) a brief description of its material impacts, risks and opportunities resulting from its materiality assessment (see Disclosure Requirement IRO-1 of this standard), including a description of where in its business model, its **own operations** and its upstream and downstream value chain these material impacts, risks and opportunities are concentrated; …'.

ESRS 2 paragraph 53 states: 'The undertaking shall disclose the following information: …

(b) an overview of the process to identify, assess, prioritise and monitor the undertaking's potential and actual impacts on people and the environment, informed by the undertaking's due diligence process, including an explanation of whether and how the process: …

  (ii) considers the impacts with which the undertaking is involved through its **own operations** or as a result of its business relationships; …'.

Because the environmenal and social ESRS have numerous references to 'own operations' when requiring disclosures, they are not replicated in this background section.

ESRS E5 paragraph 30 (ESRS E5 Disclosure Requirement E5-4 *Resource inflows*) states: 'The disclosure required by paragraph 28 shall include a description of its resource inflows where material: products (including packaging) and materials (specifying critical raw materials and rare earths), water and property, plant and equipment used in the **undertaking's own operations** and along its upstream value chain.'

ESRS E5 paragraph 31 (ESRS E5 Disclosure Requirement E5-4 *Resource inflows*) states: 'When an undertaking assesses that resource inflows is a material sustainability matter, it shall disclose the following information about the **materials used to manufacture** the undertaking's products and services during the reporting period, in tonnes or kilogrammes:

(a) the overall total weight of products and technical and biological materials used during the reporting period; …'

ESRS E5 paragraph 37 (ESRS E5 Disclosure Requirement E5-5 *Resource outflows)* states: 'The undertaking shall disclose the following information on its total amount of waste from its **own operations**, in tonnes or kilogrammes:

(a) the total amount of waste generated; …'

The Glossary of terms state: 'Operational control (over an entity, site, operation or asset) is the situation where the undertaking has the ability to direct the operational activities and relationships of the entity, site, operation or asset.

Answer

ESRS 1 paragraph 62 states that the sustainability statement shall be prepared for the same reporting undertaking as the financial statements. Therefore, the scope of any undertaking's own operation is guided by financial reporting requirements. Refer also to Chapter 2.3 of the [*Value chain implementation guidance* (IG 2)](). For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, 'own operations' refers to the operations of the parent undertaking and its subsidiaries.

Accordingly, 'own operations' of:

(a) a manufacturing group comprises the operations of its financially controlled entities (i.e. subsidiaries) to produce products the parent company/the group is selling to its customers;

(b) a construction company does not comprise operations that it does not perform in own operations but contracts to a third party (i.e. to undertakings it does not control financially) to be performed by it; and similarly

(c) a retail / trading company does not comprise the manufacturing of products - be it, own-branded or other products - purchased as finished goods from suppliers it does not control financially; however, the finished products once purchased and recognised in the balance sheet are part of own operations until sale or disposal.

On resource inflows, ESRS E5 paragraph 30 requires a description of these for own operations and its upstream value chain, but the quantitative metrics in paragraph 31 is only relevant to own operations.

On resource outflows, ESRS E5 paragraph 37 requires the disclosure of waste from own operations and ESRS E5 does not refer to operational control. A contractor to a construction company not under financial control, performing work for the construction company is a business relationship in the value chain of the construction company. Reference is therefore made to ESRS 1 paragraph 63.

The undertaking shall consider whether it has to include entity-specific disclosures relating to value chain in addition to the disclosures described above (ESRS 1 paragraph 11 (and AR 1 to 5) as well as paragraph 62 to 67 as explained in IG 2 *Value chain implementation guidance*).

To note: Operational control is mentioned in ESRS E1 *Climate change*, E2 *Pollution,* and E4 *Biodiversity and ecosystems* in addition to financial control as stated in ESRS 1 paragraph 62. Reference is made to chapter 2.3 *From own operations to value chain* of the IG2: *Value chain implementation guidance*.

ID 526 – Disclosure of a datapoint of a non-material topic / ESRS E3 Disclosure Requirement E3-4 water consumption

Category

cross-cutting

Question asked

If water consumption is only deemed material for upstream value chain [and not material to own operations], is the undertaking still allowed to include this datapoint in their report?

ESRS Reference

ESRS E3 Disclosure Requirement E3-4 (paragraph 28); ESRS 1 chapter 2; paragraphs 11, 33, 34, and 114; ESRS 1 QC 1, 4, 16, and 17

Key terms

Water consumption; non-material metric; non-material datapoint

Background

ESRS E3-4 paragraph 28 states: 'The disclosure required by paragraph 26 relates to own operations and shall include: (a) total water consumption in m^3; ….'

ESRS 1 chapter 2 *Qualitative characteristics of information* states: '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.

20. These qualitative characteristics of information are defined and described in Appendix B of this Standard.'

ESRS 1 paragraph QC 1 and QC 4 state for *Relevance*: 'QC 1. Sustainability information is relevant when it may make a difference in the decisions of users under a double materiality approach (see chapter 3 of this Standard).

Q4. Materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates, as assessed in the context of the undertaking's sustainability reporting (see chapter 3 of this Standard).'

ESRS 1 paragraph QC 16 and 17 state for *Understandability*: 'QC 16. Sustainability information is understandable when it is clear and concise. Understandable information enables any reasonably knowledgeable user to readily comprehend the information being communicated.

QC 17. For sustainability disclosures to be concise, they need to (a) avoid generic "boilerplate" information, which is not specific to the undertaking; (b) avoid unnecessary duplication of information, including information also provided in financial statements; and (c) use clear language and well-structured sentences and paragraphs. **Concise disclosures shall only include material information.** … .'

ESRS 1 paragraph 33 states for **policies, actions and targets**: 'When disclosing information on policies, actions and targets in relation to a sustainability matter **that has been assessed to be material**, the undertaking shall include the information prescribed by all the Disclosure Requirements and datapoints in the topical and sector-specific ESRS related to that matter and in the corresponding Minimum Disclosure Requirement on policies, actions, and targets required under ESRS 2. If the undertaking cannot disclose the information prescribed by either the Disclosure Requirements and datapoints in the topical or sector-specific ESRS, or the Minimum Disclosure Requirements in ESRS 2 on policies, actions and targets, because it has not adopted the respective policies, implemented the respective actions or set the respective targets, it shall disclose this to be the case and it may report a timeframe in which it aims to have these in place.'

ESRS1 paragraph 34 states for **metrics**: 'When disclosing information on metrics for a **material sustainability matter** according to the Metrics and Targets section of the relevant topical ESRS, the undertaking:

(a) shall include the information prescribed by a Disclosure Requirement if **it assesses such information to be material**; and

(b) may omit the information prescribed by a datapoint of a Disclosure Requirement if it assesses such information to be not material and concludes that such information is not needed to meet the objective of the Disclosure Requirement.'

ESRS 1 paragraph 11 states: '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.

ESRS 1 paragraph 114 states: "When the undertaking includes in its sustainability statement additional disclosures stemming from (i) other legislation which requires the undertaking to disclose sustainability information, or (ii) generally accepted sustainability reporting standards and frameworks, including non-mandatory guidance and sector-specific guidance, published by other standard-setting bodies (such as technical material issued by the International Sustainability Standards Board or the Global Reporting Initiative), such disclosures shall:

(a) be clearly identified with an appropriate reference to the related legislation, standard or framework (see ESRS 2 BP-2, paragraph 15);
(b) meet the requirements for qualitative characteristics of information specified in chapter 2 and Appendix B of this standard.'

Answer

No, to meet the qualitative characteristics of information the sustainability statement shall only include material information. An exception to this is disclosures stemming from (i) other legislation or (ii) generally accepted sustainability reporting standards and frameworks as stipulated in ESRS 1 paragraph 114.

Both information on policies, actions and targets (ESRS 1 paragraph 33) and metrics (ESRS 1 paragraph 34) related to a non-material matter is by definition also non-material and would accordingly not meet the characteristics of information quality i.e., being relevant and understandable (see ESRS 1 paragraphs QC1, QC 4, QC 16 – 17).

Accordingly, if water consumption in own operations is assessed as being non-material the related datapoint on water consumption of own operations shall not be reported.

If, water consumption in the value chain is assessed as material due to its specific facts and circumstances of the undertaking, and as ESRS E3 *Water and marine resources* does not provide for metrics of water consumption in the value chain, the undertaking shall provide entity-specific disclosures (ESRS 1 paragraph 11). Reference is made to ID 442 – *Entity-specific metrics*.

Future ESRS sector standards may include additional metrics to capture value chain.

ID 753– Financial materiality in the value chain and power purchase agreements

Category

Cross-cutting

Question asked

(1) Shall a matter included in the financial statements of the undertaking but being outside of its value chain be reported in the undertaking's financial materiality assessment?

(2) There is uncertainty whether a PPA (Power Purchase Agreement) would enter into the scope of the value chain of the undertaking. More specifically, 1) in the case of a VPPA 2) in the case of a DPPA.

ESRS Reference

ESRS 1 chapter 3.5 *Financial materiality,* paragraphs 49 and 63

Key terms

Value chain; financial materiality; power purchase agreements

Background

[As part of the question the submitter also stated: 'While Section 3.5 Financial materiality doesn't mention that the matter shall be part of the undertaking's value chain, the related risks and opportunities notions are used in the rest of the document as "in the undertaking's value chain".']

ESRS 1 paragraph 49 states: 'A sustainability matter is material from a financial perspective if it triggers or could reasonably be expected to trigger material financial effects on the undertaking. This is the case when a sustainability matter generates risks or opportunities that have a material influence, or could reasonably be expected to have a material influence, on the undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term. Risks and opportunities may derive from past events or future events. The financial materiality of a sustainability matter is not constrained to matters that are within the control of the undertaking but includes information on material risks and opportunities attributable to business relationships beyond the scope of consolidation used in the preparation of financial statements.'

ESRS 1 paragraph 63 states: '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"). …'

A power purchase agreement (PPA), or electricity power agreement, is a long-term contract between an electricity generator and a customer, usually a utility, government or company. The PPA defines the conditions of the agreement, such as the amount of electricity to be supplied, negotiated prices, accounting, and penalties for non-compliance. Since it is a bilateral agreement, a PPA can take many forms and is usually tailored to the specific application. The power generated might be renewable. Under a PPA, the customer is strictly speaking paying a provider for the energy received. Therefore, in the case of renewable energy the undertaking will not necessarily get the ancillary benefits of owning the renewable energy asset, such as the ability to get tax rebates or sell renewable energy credits.

PPAs might be in the form of a physical-PPA (customer is receiving a fixed amount of energy at a fixed price) or virtual-PPA (customer is receiving / paying cash for a fixed amount of energy based on the difference between a fixed and a variable price per unit).

Often those contracts result in parties involved receiving renewable energy certificates ('RECs').

Answer

(1) Shall a matter included in the financial statements of the undertaking but being outside of its value chain be reported in the undertaking's financial materiality assessment?

If a matter is included in the financial statements, it cannot be regarded as outside the value chain. So, a PPA be it physical or virtual is considered as being in own operations.

Financial materiality in sustainability statement includes items that arise from the undertaking's own operations and items that arise in its value chain.

A matter is material for inclusion in sustainability statement from financial materiality perspective, when it generates risks or opportunities that have a material influence, or could reasonably be expected to have a material influence, on the undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term (see ESRS 1 paragraph 49).

(2) ***More specifically: There is uncertainty whether a PPA (Power Purchase Agreement) would enter into the scope of the value chain of the undertaking. More specifically, 1) in the case of a VPPA 2) in the case of a DPPA***

A counterparty to the power purchase agreement is connected with the undertaking's activities (see ESRS 1 paragraph 63).

A physical-PPA results in the delivery of energy and it is therefore in the upstream value chain and as it relates to indirect emissions and so fall under Scope 2 emissions under the GHG Protocol.

A virtual-PPA is a financial instrument resulting in the exchange of cash. As this is part of the undertaking's activities (to manage its energy costs or to obtain Guarantees of Origin (or RECs)), this is part of its own operations and not its value chain. The purchased Guarantees of Origin may ultimately form part of categorisation of Scope 2 disclosures under ESRS E1 whether surrendered or not. For the purpose of answering this question please note that the answer does not relate to the relationship between the undertaking and the party delivering physical energy that often exists in the three party relationship involving virtual-PPAs.

As the substance of the contracts differ between a physical and a virtual PPA, the undertaking's material impacts on people and environment and the material effects of sustainability matters on the undertaking's development, performance and condition might also differ.

IG 2 *Value chain* FAQ 2: *Are financial assets (loans, equity and debt investments) considered business relationships that trigger VC information?* states: 'Business relationships and value chain as defined in Annex II Acronyms and Glossary of Terms do not exclude any types of activities and business relationships.'

ID 923 – Phase-in entity specific disclosures

Category

Cross-cutting

Question asked

Do undertakings need to include entity-specific disclosures for the first three years of reporting?

ESRS Reference

ESRS 1 paragraph 131

Key terms

Phase-in provisions; entity-specific disclosures

Background

ESRS 1 paragraph 131 states: 'When defining its entity-specific disclosures, the undertaking may adopt transitional measures for their preparation in the first three annual sustainability statements under which it may as a priority:

(a) introduce in its reporting those entity-specific disclosures that it reported in prior periods, if these disclosures meet or are adapted to meet the qualitative characteristics of information referred to under chapter 2 of this Standard; and

(b) complement its disclosures prepared on the basis of the topical ESRS with an appropriate set of additional disclosures to cover sustainability matters that are material for the undertaking in its sector(s), using available best practice and/or available frameworks or reporting standards, such as IFRS industry-based guidance and GRI Sector Standards.

Answer

Yes, entity specific disclosures are required for the first three years of reporting the sustainability information.

ESRS 1 paragraph 131 only gives a three-year period for the preparation of transitional measures under which the undertaking may as a priority derive those measures from ESRS 1 paragraph (a) or (b). ESRS paragraph 131 does not give a phase-in for entity-specific provisions themselves.

Reference is made to ESRS 1 chapter 10.2 *Transitional provision related to chapter 5 value chain* taking precedence.

Governance

ID 800 Corruption and Bribery

Category

Governance

Question asked

Do you need to disclose the total number of incidents of corruption, and the total number of incidents of bribery? Or is there some additional data needed around "nature" of each of those types?

ESRS Reference

ESRS G1-4 paragraph 25

Key terms

Corruption

Background

ESRS G1-4 paragraph 25 states the following:

The undertaking may disclose: (a) the total number and nature of confirmed incidents of corruption or bribery.

The "nature" of the incidents includes details such as the circumstances surrounding each incident, the parties involved, the methods employed, the consequences stemming from the incidents, and any relevant contextual information.

Answer

The undertaking may disclose both the total number and the nature of confirmed incidents of corruption or bribery. This entails providing not only the quantitative aspect of the incidents but also additional details that provide a more thorough understanding of the scope, impact and implications of corruption and bribery within the undertaking. It could also include types of incidents (if the undertaking reports broader non-compliance issues) or responses such as warnings versus dismissals or loss of bonusses or transfers of personnel etc. The reason for asking for the nature is given that different undertakings may take different approaches to this voluntary disclosure.

Please note that the compulsory requirement (subject to materiality) is in paragraph 24. Disclosure about the 'nature' is not required here.