



IMPLEMENTATION GUIDANCE

EFRAG IG 2

Value chain



EFRAG

sustainability reporting

Disclaimer

This implementation guidance is non-authoritative and accompanies the European Sustainability Reporting Standards (ESRS), as stipulated in Articles 19a and 29a of Directive 2013/34/EU (the Accounting Directive) but does not form part of them. This means that if anything in this guidance appears to contradict any requirement or explanation in ESRS, ESRS take precedence. This implementation guidance is issued following EFRAG's due process for such non-authoritative documents and under the sole responsibility of EFRAG.

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This implementation guidance has been developed for use by large listed and unlisted companies that are subject to CSRD. It is therefore not intended for use by listed small and medium-sized enterprises which adopt future LSME standards and other (not listed) SMEs voluntarily reporting based on the future VSME standards.

This implementation guidance relates to the sector-agnostic ESRS as adopted by the European Commission on 31 July 2023, and published in the Official Journal on 22 December 2023. Sector-specific standards may add sector specifications to be followed by specific sectors.

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 be recognised as the European voice in corporate reporting and a contributor to global progress in corporate reporting.



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Summary in seven key points

NB: this implementation guidance (IG) covers the upstream and downstream value chain (VC) of the undertaking and not its own operations. This guidance should be read with the MAIG.

1. The undertaking's sustainability statement shall include information about all material impacts, risks and opportunities (IROs) including those that arise or may arise in the context of its business relationships in the upstream and downstream value chain. Business relationships are not limited to direct contractual relationships, see below for further details.
2. The undertaking is not required to include value chain information in all disclosures, but only when it is connected to material IROs beyond its own operations, due to its business relationships, and when specifically required by the disclosure requirement.
3. 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.
4. Topical standards require disclosures about policies, targets and actions (PATs) for material matters. In particular, they require either the disclosure of such PATs or a statement about their absence. Limited to the extent that those policies, actions and targets involve actors in the value chain, when describing the PATs for material matters, the disclosure shall include information about how these address material upstream and/or downstream VC IROs.
5. Topical standards require to include VC data only for a few metrics. However, when the undertaking considers that a material IRO in the VC is not sufficiently covered by the requirements in ESRS, it shall include additional entity-specific disclosures, including metrics on when such information is necessary in order to enable users to understand the undertaking's material impacts, risks or opportunities.
6. When it cannot collect primary VC information from actors in its value chain for the materiality assessment or in order to prepare its disclosures of material IROs after making reasonable efforts, the undertaking shall estimate the missing information. When estimating the missing information, it shall use 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. Depending on the circumstances, the materiality assessment may be validly conducted without primary information being collected from actors in the value chain.
7. The inclusion of VC information in the sustainability statement does not affect the reporting boundaries, which correspond to the boundaries of the entities included in the perimeter of its consolidated financial statements. The inclusion of VC information correspond to 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. Refer also to Chapter 2.3 below on operational control which is relevant to ESRS E1 *Climate change*, ESRS E2 *Pollution* and ESRS E4 *Biodiversity and Ecosystems*.



1. Introduction

8. The objective of this guidance is to support the implementation activities of preparers and others using or analysing ESRS reports, specifically on 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 Directive (EU) 2022/2464, as regards Corporate Sustainability Reporting (referred to as 'the CSRD').
9. The content of this document has been developed on the basis of the Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023, supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards.
10. In its implementation supporting 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.
11. As an example, when the implementation supporting 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.

A note on Corporate Sustainability Due Diligence Directive (CSDDD)

As stated in ESRS 1 paragraph 58: 'ESRS do not impose any conduct requirements in relation to due diligence; nor do they extend or modify the role of the administrative management or supervisory bodies of the undertaking with regard to the conduct of due diligence.'

ESRS requires transparency around the reporting undertaking's due diligence processes but do not assume any compliance with the CSDDD or other behavioural frameworks.

Consistent with the ESRS text in the Delegated Act, this guidance does not reflect the text of the CSDDD, because the disclosure obligations of the CSRD are independent of the CSDDD obligations.

In practice, the CSDDD compliance may be conducive to better CSRD/ESRS reporting. However, even if value chain due diligence obligations do not exist for certain companies under the CSDDD, this does not modify the definition of the value chain for reporting purposes, i.e. the transparency obligations under ESRS.

Structure of the guidance

12. The document is organised in three chapters as follows:
 - (a) The next chapter covers how to navigate VC requirements in ESRS, which is the basis for the rest of the document.
 - (b) The chapter following it 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 VC coverage map for Set 1 ESRS explaining the coverage of the upstream and downstream VC as required by ESRS (excluding considerations of entity-specific disclosures and SFDR indicators).

Cross references to the MAIG

13. 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.
14. Please note that references to the [MAIG are made in this blue colour](#), whereas references in [green designate this document](#).

Acronyms and abbreviations used

15. The acronyms in this document are used as follows:

CSDDD - Corporate Sustainability Due Diligence Directive

CSRD - Corporate Sustainability Reporting Directive

Delegated Act - Commission Delegated Regulation supplementing Directive 2013/34/EU as regards sustainability reporting standards

DR - Disclosure Requirement

ESRS - European Sustainability Reporting Standards

GHG - greenhouse gases or the GHG Protocol

GRI - Global Reporting Initiative

IROs - impacts, risks and opportunities

ISSB - International Sustainability Standards Board

LSME - ESRS for Listed Small and Medium Enterprises (SMEs)

PAT - policies, actions and targets

MA - materiality assessment

MAIG - the Materiality Assessment Implementation Guidance; and

VC - value chain.

Annexes to the Delegated Act:

Annex 1: ESRS including appendices

Annex 2: Acronyms and glossary of terms

2. Navigating value chain under CSRD and ESRS

16. 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.
17. ESRS have been developed according to this legal requirement. The CSRD does not provide any additional definitions or guidance on VC. However, with reference to impacts, the CSRD refers to international instruments of sustainability due diligence which specify how the undertakings are expected to identify, address and report on impacts across their VC.



18. The definitions of 'value chain', 'actors in the value chain' and 'business relationships' are defined in [Annex 2](#) of the July 2023 Delegated Act.
19. Not all Disclosure Requirements (DRs) and datapoints in sector agnostic ESRS require the inclusion of information about the undertaking's upstream and downstream VC. In many cases the undertaking is expected to focus on its own operations.

General requirements

20. The general requirements relating to all disclosures on VC can be found in ESRS 1 *General requirements*:
 - (a) the general requirements for reporting on VC are in chapter 5;
 - (b) Application Requirements AR 17 set out guidance on 'Estimation using sector averages and proxies'; and
 - (c) lastly, but importantly, ESRS 1 contains specific transitional provisions with respect to VC in Chapter 10.2.
 - (d) 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 stipulated 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 cover the VC.

Detailed requirements

21. Other detailed requirements about value chain can be found in ESRS as follows.
 - (a) ESRS requires disclosures concerning the process and outcomes of the materiality assessment which are covered in ESRS 2 *General disclosures* (IRO-1 and SBM-3), accompanied by SBM-1. For more on this, see below [FAQ 4 How should information about the VC be disclosed](#) in the context of the MA as well as rows 1 through 3 of the VC coverage map of ESRS. For details about the materiality assessment process, please refer to the [MAIG](#) and for the related VC aspects, please see below [FAQ 3 How should the MA process be organised to properly capture material IROs in the VC](#). Please also refer to [MAIG FAQ 10 Should the assessment of IROs rely on quantitative information?](#)
 - (b) All topical standards require undertakings to disclose their policies, actions and targets for material IROs; to the extent that such policies, actions and targets address material IROs in the VC, this will be reflected in the disclosures. The minimum disclosure requirements with respect to policies, actions and targets require information on scope such as whether it relates to the VC per ESRS 2 paragraphs 65(b), 68(b) and 80(c). (See [Chapter 2.5 Coverage of the VC for Policies, Actions or Targets](#)). 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

Alignment with the ISSB and GRI

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



material IROs related to these groups of people in the VC and their management. As a reminder, the undertaking can comply by disclosing that it has not adopted policies, actions and targets with reference to the relevant material 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). Please refer to rows 4 and 5 of the [VC coverage map](#) of ESRS.

(c) There are only few sector-agnostic metrics in topical ESRS that require VC information (see [Chapter 2.6 Coverage of the VC for metrics](#)). ESRS S2 to S4 for instance do not include metrics per se. The other metrics do not refer to the value chain. However, this includes some information about procured materials, please refer to rows 6 to 8 of the VC coverage map of ESRS.

(d) Finally, when an undertaking concludes that a material IRO is not sufficiently covered by a ESRS to produce a sustainability statement that meets the qualitative characteristics of information, it shall provide additional disclosures on an entity-specific basis to enable users to understand its IROs (ESRS 1 paragraph 63 and 65 as well as paragraph 11 and AR 1 to 5). These disclosures shall include, where necessary, appropriate metrics covering the relevant parts of the VC related to the relevant material IRO as selected by the undertaking (i.e. there is no standardisation of these metrics in the sector-agnostic standards). While judgement is required in determining whether and what disclosures are required, the entity-specific disclosures dimension is not voluntary but a mandatory requirement.

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, including raw material, components 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 to the reporting undertaking's position in the chain.

However, there are other entities and individuals that are connected to the undertaking's operations, products or services without being 'suppliers', e.g., local police protecting the undertaking's assets, as they may cause an impact by e.g., using excessive force on people trespassing. In this case, there is no business relationship, but there is a value chain impact. It may meet the materiality threshold if it is considered severe enough.

Value chain coverage map

22. [Chapter 4](#) of this document presents the VC coverage map illustrating 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?

23. While the focus of this Implementation Guidance is on upstream and downstream VC, the definition of value chain in [Annex 2](#) 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: 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.*

24. ESRS use the term 'value chain' in the singular, although it is recognised that undertakings may have multiple value chains.
25. 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 or use products or services of the reporting undertaking or waste stream by the customers or end-users.
26. [Annex 2](#) defines 'business relationships' as *'The relationships the undertaking has with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services. Business relationships are not limited to direct contractual relationships. They include indirect business relationships in the undertaking's value chain beyond the first tier, and shareholding positions in joint ventures or investments. 'as [t]he relationships the undertaking has with business partners, entities in its value chain, and any other non-State or State entity directly linked to its business operations, products or services. Business relationships are not limited to direct contractual relationships. They include indirect business relationships in the undertaking's value chain beyond the first tier, and shareholding positions in joint ventures or investments.'*
27. Setting out the VC activities may help identify the VC actors¹.

¹ EFRAG has consulted from 21 January to 21 May 2024 on an Exposure Draft of ESRS for listed SMEs (LSME ED). Differently from the sector-agnostic standards that support the preparation of consolidated sustainability statement for the group, consistent with the CSRD, LSME ED has been developed to support the preparation of the individual (i.e., not consolidated) sustainability statement. In the LSME ED material IROs of the subsidiaries are included in the sustainability statement as IROs arising from the parent's business relationship with them, i.e., as part of the value chain.

Should IROs linked to all actors in the VC be considered?

28. ESRS do 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 (ESRS 1 paragraph 64). When assessing material IROs, all relevant actors (both in 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 who are associated with 'hot spots' and who likely expose to the likelihood of actual and potential impacts (therefore generating impacts on people and/or environment, which can in turn be sources of risks and opportunities); or
 - (b) those actors with respect to whom the business model of the undertaking shows key dependencies in terms of products or services (therefore generating risks and opportunities for the undertaking).

How does leverage or influence over the VC impact reporting?

29. In some cases, an undertaking may have leverage or be able to exert influence over actors in its VC. Examples include cases where the undertaking is a large supplier or customer and thereby exerts influence on its business relationships to manage its impacts.
30. 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. Other factors may include customs in the industry, the behaviour of the reporting entity's competitors, and the willingness or ability of suppliers and customers to provide such information.
31. However, leverage is not a factor when it comes to determining whether IROs that arise in the VC are material or not. Leverage may affect the ability of the company to obtain data and/or information from its counterparties in the VC. This may be relevant for the reporting of material impacts as well as for reporting metrics, including entity-specific information (See ESRS 1 AR 1 to AR 5) and may lead the undertaking to use estimates and proxies.

2.2 Why does VC matter?

32. The CSRD and ESRS require that the sustainability statement include material information about the upstream and downstream VC.
33. The reason for this is that the impacts, risks and/or 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, focusing on own operations would provide only a partial picture of the impacts on people and the environment connected to the undertaking's activities, products and services. Furthermore, this would not allow for an appropriate identification of risks and opportunities. Consider the following examples.
 - (a) A EU garment and apparel company sells basic T-shirts produced in a country outside the EU by an external supplier and reports under ESRS. The company may pay its employees an adequate wage under collective bargaining agreements for



its operations in the EU. However, assuming that 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).

- (b) With a supplier of wood, a European retailer makes toys in a factory outside the EU, where legal requirements are less stringent. 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 rather than accepting bribes as is currently the case, it could result in significant fines, possibly even closure for the manufacturer. This could have a direct and significant financial impact on the European retailer.
- (c) An electronics producer may have processes in place to control and minimise the packaging and other waste from its own operations, but its products may create electronic waste which may in turn be hazardous to animals and wildlife when discarded. This aspect is connected to the undertaking's downstream value chain, i.e. to impacts deriving from the end use of its products.
- (d) As highlighted by Carbon Disclosure Project ([CDP](#)), Scope 3 GHG emissions are expected to be material for many or most undertakings.

2.3 From own operations to value chain

The reporting group as a starting point

- 34. ESRS 1 paragraph 62 states: 'The sustainability statement shall be for the same reporting undertaking as the financial statements.' In the [Accounting Directive](#), a group is defined as 'a parent undertaking and all its subsidiary undertakings'. As this is derived from financial reporting, sustainability professionals should obtain assistance from the financial reporting function to understand the implications that this has for the ESRS sustainability statement.
- 35. Sometimes subsidiaries are not included in the financial reporting consolidation on the basis of materiality, for practical reasons. Such subsidiaries may still have material sustainability matters that need to be reported in the consolidated sustainability statement. Therefore, the materiality of their IROs need to be evaluated as well. Please refer to [MAIG Chapter 5.2 FAQs on financial materiality](#) for insights into these for the purpose of the sustainability statement.

Internal or intragroup transactions

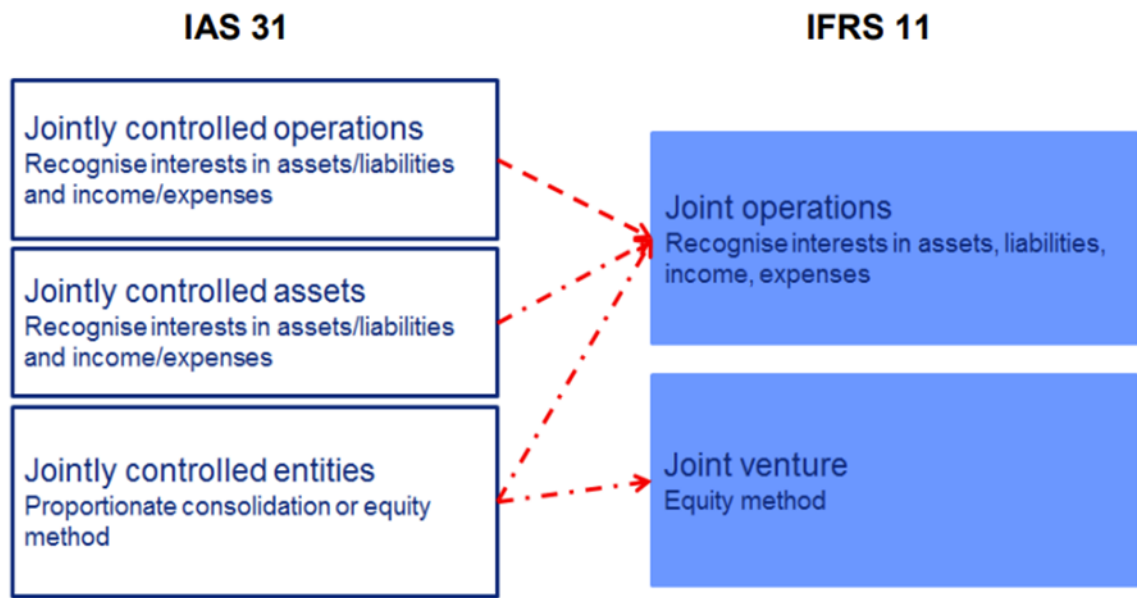
- 36. For sustainability reporting purposes, groups must include information about material IROs of the subsidiaries. The elimination of internal transactions in the preparation of consolidated financial statements has no implications for the identification of IROs. The underlying impacts that occur in the group's operations are in scope of the reporting, when material, as well as the ones identified in the VC. For example, the impacts from



the emissions from transport, even if not for external sales, do not disappear merely because they relate to an internal/intragroup transaction. Therefore, groups should consider IROs related to internal transactions where appropriate.

Joint arrangements

37. For undertakings that apply IFRS, effective since 2013, IFRS 11 Joint Arrangements changed the financial reporting treatment under IAS 31 Interests in Joint Ventures as follows:



38. This means that rather than proportional consolidation, for joint operations, a joint operator with joint control will recognise in relation to its interest in a joint operation:
- Its assets, including its share of any assets held jointly;
 - Its liabilities, including its share of any liabilities incurred jointly;
 - Its revenue from the sale of its share of the output arising from the joint operation;
 - Its share of the revenue from the sale of the output by the joint operation; and
 - Its expenses, including its share of any expenses incurred jointly.
39. This means that its assets and liabilities forming part of the financial perimeter are own operations rather than value chain.

Operational control

40. For certain environmental matters, ESRS refer to the concept of 'operational control' to identify situations where information about IROs of a site, an asset or an entity under operational control but outside the financial control perimeter have to be reported.



Operational control - definition

41. In alignment with the [GHG Protocol](#), ESRS include the concept of operational control, which is defined in Annex 2 of the Delegated Act 'as the situation where the undertaking has the **ability to direct the operational activities and relationships of the entity, site, operation or asset**'. The GHG Protocol adds that this is where the undertaking has the full authority to introduce and implement the operating policies, which often implies also executing such operations.
42. AR 40 of ESRS E1 also explains, in the context of GHG emissions, that this happens 'when the undertaking holds the license - or permit - to operate the assets from these associates, joint ventures, unconsolidated subsidiaries (investment entities) and contractual arrangements'.
43. Operational control may also apply where the undertaking is legally recognised under certain regulations (for example the EU Emissions Trading system) as an "operator"² of a facility. This implies specific legal rights and obligations.
44. The GHG Protocol (page 18) also emphasises that operational control does not mean that an undertaking necessarily has authority to make all the decisions concerning an operation. For example, large capital investments may require approval of all partners that have joint financial control. Not having the authority to make all decisions concerning an operation does not affect the determination of operational control.
45. There is no definition of 'operations' in the CSRD or the ESRS. On Page 23 of the GHG Protocol reads, as follows: 'The term "operations" is used here as a generic term to denote any kind of business activity, irrespective of its organizational, governance, or legal structures.'
46. Assessing whether operational control exists depends on the undertaking's specific facts and circumstances, including the sector(s) where it operates, and on the types of contractual relationships prevailing in that sector(s).

Operational control - ESRS E1, GHG emissions

- 47. Under ESRS E1, Scope 1 and 2 GHG emissions shall include, in addition to the emissions of the parent and its subsidiaries, also the GHG emissions of sites, assets and entities under operational control, as a separate line item.**
48. Supplementing the definition in Annex 2 of the Delegated Act, ESRS E1 paragraph 46 focusses on the treatment of entities related to the reporting group (such as associates, joint ventures and joint arrangements not structured through an entity) under operational control. The treatment means that the reporting is accountable for 100% of the relevant emissions rather than the relevant equity holding.

² As explained in the GHG Protocol on page 21: 'Since compliance responsibility generally falls to the operator (not equity holders or the group company that has financial control), governments will usually require reporting on the basis of operational control, either through a facility level-based system or involving the consolidation of data within certain geographical boundaries (e.g. the EU ETS will allocate emission permits to the operators of certain installations).'

49. ESRS E1 AR 40 clarifies the definition in Annex 2 whereby the undertaking shall include 100% of the GHG emissions of the entities it operationally controls in its disclosures. It provides an example whereby, when an undertaking has a contractually defined part-time operational control, it shall consolidate 100% the GHG emissions emitted during the time of its operational control.
50. This means that the reported GHG emissions will reflect the terms and conditions of the relevant agreements. For example, when the reporting undertaking is the operator of the activities during a certain phase of the production process and its partner is the operator in another phase, the reporting undertaking would report in its scope 1 and 2 the GHG emissions that pertain to the phase that it operationally controls.
51. ESRS E1 (paragraph 50 (b)) requires disclosing the Scope 1 and 2 emissions of undertakings under operational control separately from the ones related to the consolidated group (presented following ESRS E1 paragraph 50 (a)). The latter correspond to the outcome of the financial control approach in the GHG Protocol. Please note that a literal reading of paragraph 50(b) may make it seem as if this is only applicable to investees (associates, joint arrangements and unconsolidated subsidiaries, etc.) under operational control but this is not the intention. GHG emissions of entities, assets and sites under operational control but without financial control will also be included in the disclosure under paragraph 50(b). Furthermore, for IFRS preparers, any assets, including the undertaking's share of any assets held jointly in joint operations (defined in IFRS11) or its liabilities, including its share of any liabilities incurred jointly in joint operations (defined in IFRS 11) will be part of the balance sheet for financial reporting purposes, i.e., included in disclosures under paragraph 50(a). In addition, where the reporting undertaking has operational control over its joint operators' (defined in IFRS 11) assets, the GHG emissions arising from this will be included in scope 1 and 2 under ESRS E1 paragraph 50(b).

Targets and operational control

ESRS E1-4 requires transparency about the reporting undertaking's targets for its emissions. If the undertaking does not set targets for assets, sites or entities under its operational control (as it does not have control over the investment budget to reduce emissions), the disclosure will reflect the target(s) as defined, i.e. only for the consolidated group. However, the disclosure should be clear about the scope of the target(s).

Operational control - Other environmental standards

52. ESRS E2-4 *Pollution of air, water and soil* also specifically includes those emissions from facilities under the operational control of the undertaking. Similarly, ESRS E4 *Biodiversity and ecosystems* in paragraph 16(a) also includes sites under the operational control of the undertaking.

Operational control - ESRS 2, Basis for preparation

53. ESRS 2 BP 1 (paragraph 5) requires that the undertaking discloses to what extent the sustainability statement covers the undertaking's upstream and downstream value chain. When appropriate, the undertaking should describe whether operational control was considered or not.



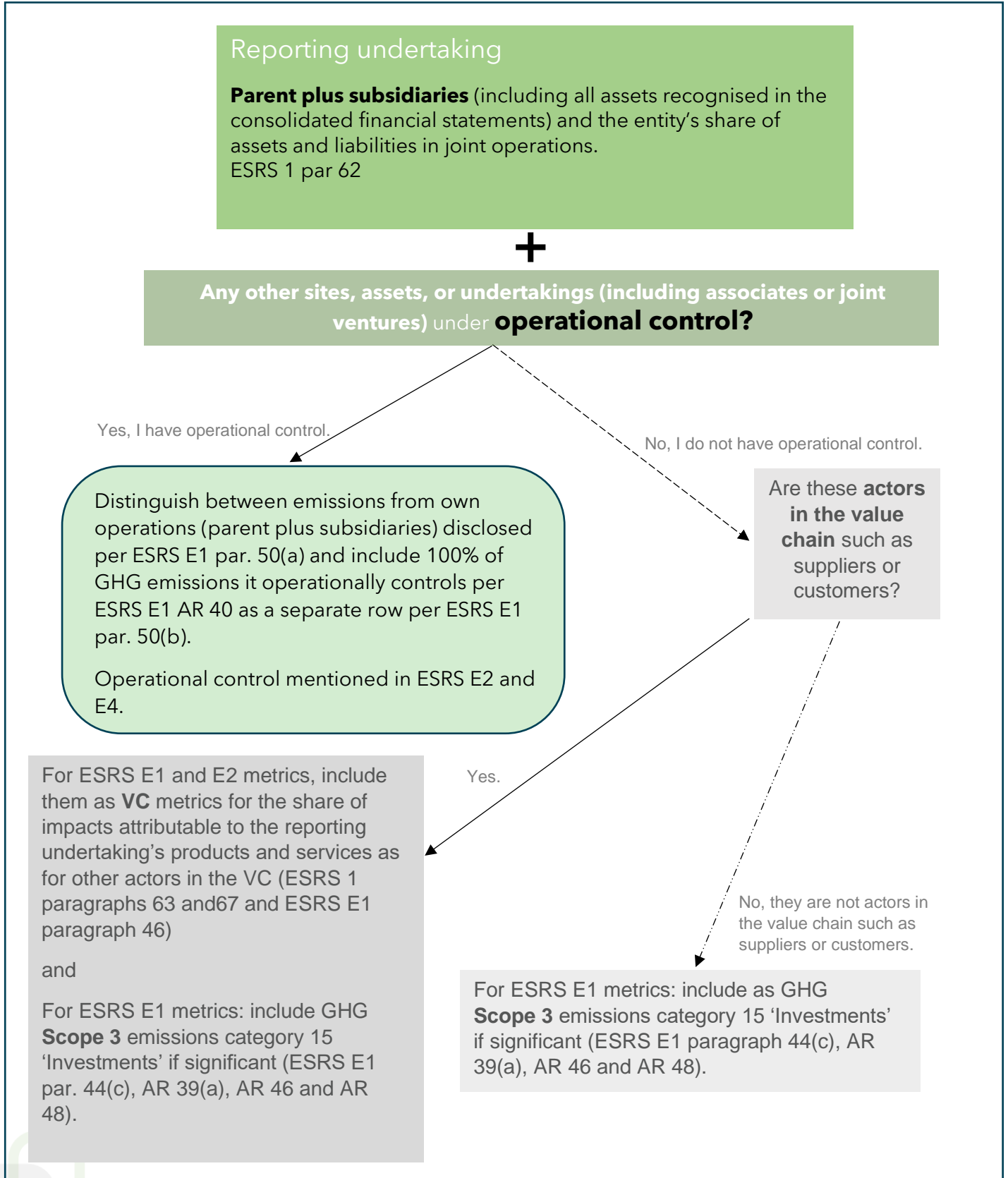
Compatibility of ESRS E1 and the GHG Protocol

54. As described in paragraph 34 above, ESRS use a financial control approach while the GHG Protocol allows for three possible reporting approaches. The disclosure of scope 1 and 2 under ESRS E1 paragraph 50(a) is aligned with the financial control approach under the GHG Protocol. However, in order to provide further information, ESRS requires separate disclosures about the emissions from items under operational control (ESRS E1 paragraph 50(b)).
55. The intention of this step was to reduce the options under the GHG Protocol and to thus improve comparability, while maintaining compatibility with the GHG Protocol, at level of ESRS E1 paragraph 50 (a). The requirement to disclose emissions separately from items that are not financially controlled but that are under the operational control of the reporting undertaking provides a full picture of the impacts of the undertaking. This additional disclosure requirement also recognises that the environmental regulations often apply to the operator rather than the owner of assets.
56. ESRS E1 does not aim at requiring the full implementation of the operational control approach under the GHG Protocol, as it maintains financial control as the primary selected approach.
57. An undertaking is able to reconcile ESRS reporting with that under a GHG Protocol operational control approach, by deducting the GHG emissions from those assets, sites etc., that are under financial but not operational control from its total Scope 1 and 2 emissions under ESRS E1.



Environmental reporting value chain decision tree

59. The following decision tree summarises some of the important aspects related to the measurement of emissions of GHG in ESRS E1 and of pollutants in ESRS E2. The same approach is also applicable in the preparation of the disclosure of the list of material sites in ESRS E4 paragraph 16:



Operational control does not apply to Social standards

60. Definitions used in ESRS S1 *Own workforce* and S2 *Workers in the value chain* focus on the contractual arrangements between the workers and the undertaking. Similarly, the basis for ESRS S3 *Affected communities* and S4 *Consumers and end-users* is the relationship of these stakeholders with the reporting entity.
61. Operational control is not relevant to these standards.

Including value chain information

62. The information about material IROs of the parent and subsidiaries is 'extended' in order to cover VC information. This is defined in ESRS 1 paragraph 63 as information on the material IROs connected to the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain. This may include associates and joint arrangements where they are also actors in the value chain of the reporting undertaking, such as when they are customers or suppliers as described below.
63. Value chain information is part of the sustainability statement in the following three aspects:
 - (a) the materiality assessment - please refer to Chapter 3 FAQ 3 How should the MA process be organised to properly capture material IROs in the VC?
 - (b) the description of whether (and if so, the extent to which) the reporting undertaking's policies, actions and targets cover its VC - please refer to [Chapter 2.5 Coverage of the VC for PAT](#).
 - (c) metrics related to the VC - please refer to [Chapter 2.6 Coverage of the VC for Metrics](#).



Specific group situations: associates and joint arrangements

64. Accounting frameworks generally have specific treatments for certain investees, such as associates and joint ventures, to signify a difference in relationship compared to when one has control from a financial reporting perspective resulting in a parent/subsidiary relationship. However, the starting point for ESRS reporting is not equity accounting or proportional consolidation, as one may find under financial reporting.
65. ESRS 1 paragraph 67 states that when associates or joint ventures are part of the undertaking's VC, for example as suppliers or customers, the undertaking shall include information required by ESRS 1 paragraph 63 consistent with the approach adopted for the other business relationships in the VC³. 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/or services through its business relationships (ESRS 1 paragraph 67).
66. Where associates and joint ventures do not form part of the value chain as suppliers or customers (referred to below as actors in the value chain), they are treated as investments. Investments form part of the undertaking's business relationships (as defined). As such, they may give rise to impacts that are connected to the undertaking and that are to be considered in the materiality assessment and reported when material. However, topical ESRS do not have specific reporting requirements that indicate how to measure these impacts, apart from GHG Scope 3 Category 15 disclosures where significant, in accordance with ESRS E1 paragraph 44(c), AR 39(a) as explained in AR 46 and AR 48.

Purchase transactions with an associate

An undertaking, P, produces chairs with wood sourced from another undertaking that is classified as an associate (A) for its financial reporting. P holds an equity share in A of 30%. P buys 10 tons of wood from A to produce its chairs. P will treat A in the same way as any other supplier when considering the impacts connected with the wood purchased from A. Therefore, in this case, the impacts related to the 10 tons of wood purchased (i.e. impacts that are directly linked to the undertaking's products and services through its business relationships) rather than limiting its impacts to its equity share in A as a basis for estimating.

Other investments, no further transactions.

67. Business relationships with the investees may give rise to impacts that are connected to the undertaking and that are to be considered in the materiality assessment and reported when material. There are no specific requirements in topical standards on how to measure impacts that are connected to the undertaking through its investments without joint control and/or significant influence, meaning generally below 20%, apart from GHG Scope 3 Category 15 disclosures as explained in paragraph 66.

³ This is not the case when operational control applies.

Entity-specific disclosures

68. As explained in paragraph 69 below, in the cases above, apart from the materiality assessment process, the undertaking may also have to provide entity-specific information, i.e. more than the specified requirements in ESRS relating to the VC.

2.4 Which IROs in the VC are to be disclosed?

69. The two overarching requirements in ESRS 1 that are applicable here are:
- (a) paragraph 63 requiring information on material IROs connected to 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.
70. An impact may be material to the reporting undertaking if it arises in any part of the VC, including at any tier of its upstream VC or 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 own operations, products or services via business relationships (see also [MAIG FAQ 2 What is meant by the undertaking being "connected" with an impact?](#)).
71. The identification of IROs in the 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 Coverage of the VC for Policies, Actions and/or Targets (PATs)

72. To the extent that the undertaking has PAT in place that address VC actors, for material IROs (including those in the VC), it should disclose this (ESRS 2 paragraphs 64(b), 67(b) and 70(b)). 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.
73. VC information coverage is also important for ESRS E1-1 paragraph 16(b), which requires disclosing the decarbonisation levers identified by the undertaking in setting its targets and defining its actions, including levers in the VC. This type of information



is expected to be primarily needed in order to set and manage the targets and implement the actions. Reporting is expected to use data existing for such purposes.

74. 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).
75. In addition, the undertaking should always consider the need to provide entity-specific information. Please refer to paragraph 69 (b) above.
76. In ESRS 4 *Biodiversity and ecosystems*, there are specific requirements dealing with value chain information: ESRS 4-1 Transition plan and consideration of biodiversity and ecosystems in strategy and business model, the topical specification ESRS 2 IRO-1 *Description of processes to identify and assess material biodiversity and ecosystem-related impacts, risks, dependencies and opportunities* as well as ESRS E4-4 *Targets related to biodiversity and ecosystems* (paragraph 32(c)). These do not necessarily result in the need to collect VC data from actors in the VC solely for the purpose of reporting. The undertaking is expected to leverage on information that is collected for business purposes, e.g., E4-1 paragraph 13, E4 ESRS 2 IRO 1 paragraph 17(a), and E4-4 paragraph 32(c).

2.6 Coverage of the VC for Metrics Disclosure Requirements

77. ESRS DRs related to metrics cover only own operations except for:
 - (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) entity-specific disclosures where the undertaking determines whether and, if so, what VC information is required (see paragraph 79 below).
78. As described in the value chain map in Chapter 4 below, there may be qualitative disclosures required under ESRS. A few examples are listed below:
 - (a) Disclosure Requirement ESRS E5-4 *Resource inflows* requires a description of resource inflows where material which may include a description of the IROs in the value chain (ESRS 5 paragraph 30). However, when disclosing the quantification of materials used in the production of the undertaking's products and services, this relates only to own operations (ESRS 5 paragraph 31). The undertaking determines whether additional information on the VC is needed on an entity-specific basis.
 - (b) ESRS E5-4 paragraph 30 requires a qualitative description of the undertaking's resource inflows along the upstream value chain. ESRS E2-5 and ESRS E5-5 refer to materials procured and used within the undertaking. While they do not explicitly refer to value chain information, the impacts that arise from the upstream value chain are indirectly covered by the description of the procured material.



- (c) 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* addresses impacts on communities affected directly by the undertaking as well as by actors in the VC. These standards do not specify any metrics, but the ESRS require the undertaking to consider entity-specific metrics, as explained below.

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

79. Beyond the specific provisions on metrics in the sector-agnostic ESRS, the undertaking shall provide additional VC metrics information or integrate VC data into its 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 read in conjunction with ESRS 1 paragraph 65). In particular, ESRS require the undertaking to consider appropriate entity-specific metrics needed for understanding of the impacts or tracking the 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 upstream VC or supply chain on activities that have a high impact on the environment;
 - (b) the percentage of workers in value chains in high-risk areas covered by social security schemes; and
 - (c) the percentage reduction in health and safety incidents compared to incidents in the prior period or as compared to a base period where the quality of the information can be assured.
80. It is important to note that this is relevant only for those activities of VC actors that are associated with material IROs and not for all VC actors. Also, these disclosures are not standardised, and the selection of the appropriate metric is in the purview of the reporting undertaking while considering the needs of users and the qualitative characteristics of information.
81. Sector-specific ESRS will cover the inclusion of VC data in the undertaking's 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 draw inspiration from the available best reporting practices (see ESRS 1 paragraph 131(b)).

2.7 How do the transitional requirements work?

82. The general transitional provisions in ESRS 1 from [paragraph 130](#) onwards allow for a temporary limit for 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, both for qualitative and quantitative information, are limited in their first three years of reporting.
83. The transitional provisions are intended to provide reporting undertakings with more time to prepare for the new reporting regime in case that 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 regardless of whether the VC actor is an SME.



84. The steps an undertaking can consider during this time may include:
 - (a) updating contracts with actors in the VC to reflect the status of new implemented policies or target tracking, such as foreseeing the provision of periodic information;
 - (b) Stakeholder engagement and other enhancements to the materiality assessment;
 - (c)
 - (d) preparing technological infrastructure as well as other types of infrastructure required for reporting; and
 - (e) improving knowledge about the structure of the VC, specific actors involved and associated impacts and dependencies.
85. 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 it made to obtain the necessary information;
 - (b) the reason(s) why it could not obtain the necessary information; and
 - (c) its plans to obtain the necessary information in the future.
86. In addition, during the transitional period, reporting undertakings may limit information to 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)).
87. 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)) during the transitional period.
88. Starting from its fourth year of reporting under ESRS, the undertaking shall comply with ESRS 1 paragraph 63 (ESRS 1 paragraph 135) as explained in this document.
89. 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 an average of 750 employees at balance sheet dates, may omit datapoints on Scope 3 emissions and the 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 that have 750 or less employees during the financial year.

Transitional provision with respect to entity-specific disclosures

90. The transitional provision related to value chain (paragraphs 132 to 135 of ESRS 1) covers also the VC information to be covered by entity-specific disclosures. There is no three-year transition with respect to entity-specific disclosures that do not include 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.
91. The provision of entity-specific disclosure under ESRS 1 paragraph 11 is not optional in the first three annual sustainability statements. It is mandatory. In the first three



annual sustainability statements, when the reporting undertaking is defining its entity-specific disclosures, it may 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) using the available best practice and/or available frameworks (such as IFRS or GRI sector-specific requirements).

2.8 What is the LSME cap and does it impact one's disclosures?

92. Article 29b (4) of the CSRD limits the VC information that the ESRS shall require undertakings in the scope of the CSRD to obtain from small- and medium-sized enterprises (SMEs) for their reporting under ESRS. ESRS may not require disclosures which will result in reporting undertakings having to request information from the SMEs in their VC if such information goes beyond the disclosures required in the listed SME (LSME) ESRS.
93. This limitation is often referred to as the 'LSME cap' and it aims at limiting the burden for SMEs and to embed proportionality in the ESRS.
94. The LSME ESRS are still under development. EFRAG is currently consulting on LSME Exposure Draft (consultation ends on 22 May 2023) and one of the aspects to cover in the consultation is the approach to the implementation of the LSME cap.

3. Frequently asked questions (FAQ)

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

FAQ 1: Where does the VC begin and end?

96. 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 to 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 to 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 chain not connected to the undertaking's operations, products and services are outside of the scope of impact materiality (see also [MAIG FAQ 2 What is meant by the undertaking being 'connected' to an impact?](#)); and
 - (b) relevant risks and opportunities are those attributable to business relationships, in particularly with actors in the VC that are beyond the scope of consolidation used for the preparation of financial statements for financial materiality (ESRS 1 paragraph 49).
97. To assess potential and actual impacts, it is important that the undertaking identify in particular:



- (a) the location and characteristics of suppliers including beyond the first tier of their upstream VC or 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.
98. 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.
99. To assess risks and opportunities, the undertaking considers its own dependencies on natural, human and social resources. The undertaking identifies potential changes in the availability, price and quality of such resources, which are sources of risks and opportunities, including those stemming from its upstream and downstream VC. The following three examples illustrate this concept.
- (a) A company has a tier-1 supplier, that provides it with the main components of its final products, in a region with water scarcity. To provide the components, 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 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 production.
 - (b) If the buying price does not cover the cost of a product bought, it may increase the pressure on the working conditions for the suppliers. If the purchasing department of the reporting entity does not understand lead times or ignores 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.
 - (c) 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, creating consequences for the production of the company active in the food sector. Active spot markets with delivery close to the company may alleviate the risk of disruption but may have implications for pricing.

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

100. Yes- business relationships and VC, as defined in Annex 2 of the July 2023 Delegated Act does not exclude any types of activities or business relationships.
101. ESRS 1 AR 12(b) explains 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 to the reporting undertaking by way of the relationship created by the loan agreement.
102. Per paragraph 66, for investments there is currently only disclosures under Category 15 of GHG emissions where significant under ESRS E1.



103. 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 MA process be organised to properly capture material IROs in the VC?

1. Basic principles

104. The materiality process is the process by which the undertaking determines material information on sustainability impacts, risks and opportunities and this includes information related to the VC, but not information on each and every actor in the VC. Therefore, for the identification of impacts, risks and opportunities within the materiality assessment, the undertaking should focus on the parts of its value chains where material impacts are most likely to occur. In general, the starting point is the assessment of impacts, although there may also be material risks and opportunities that are not related to the undertaking's impacts. As outlined in the [MAIG, Chapter 3 How is the materiality assessment performed?](#), the undertaking should design a process that is fit for this purpose, as required by ESRS 1 Chapter 3 and disclose it, per the requirements set out in ESRS 2 IRO-1. An undertaking, , shall design a process that is fit for this purpose based on its specific facts and circumstances, factoring in consideration of the depth of the assessment. This principle also applies to the value chain.
105. The ESRS clarify that the materiality assessment process is informed by the due diligence process (where relevant).

2. Materiality assessment steps

106. Guidance on the organisation of the materiality assessment process can be found in the [MAIG, Chapter 3 How is the materiality assessment performed?](#) As explained there (emphasis added): *'ESRS do not mandate how the materiality assessment shall be 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.'*
107. With this caveat, the [MAIG](#) provides guidance for the general organisation of the MA process. The guidance included below reflects how VC aspects can be considered in the possible process.

Step A. Understanding the context

108. As explained in the [MAIG](#), the first step in the MA process is understanding the context in which the undertaking operates. Therefore, the undertaking needs to understand its VC in terms of the business actors involved, their size, the sectors or nature of their activities, geographical locations, and processes. This is a starting point for the identification of where IROs are likely to arise.



109. The context also includes understanding the undertaking's strategy and business model and how they are connected to possible material IROs.
110. The strategy of the undertaking will influence its business model, which will focus on its own operations but also include aspects around its upstream and downstream value chain. All of this will be considered in its materiality assessment.
111. The undertaking can consider tracing or mapping its VC activities and actors to identify whether and which parts of its value chains are in areas of heightened risks. In some cases, if the undertaking does not have reliable information on the geographical location of its VC (for example beyond the first tier), it may map the IROs associated with global value chains for materials, products and services it uses or produces, to the extent that they are relevant to its VC. For example, a chair manufacturer may use products such as steel, wood, foam and fabric in its business. These raise questions around the origin of their components (e.g. oil used to produce foam and cotton for the fabric) and the transportation used to deliver them to the undertaking. Are there any environmental (deforestation, biodiversity, water usage) or social issues (working conditions, impact on communities) in the 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.
112. As explained in the general instructions in the [MAIG](#), engagement with affected stakeholders can support the assessment and validation of the impacts. The undertaking should also identify (likely) affected stakeholders and consider engaging with them. See also [MAIG FAQ 17 What is the role of silent stakeholders and how should they be considered?](#)

Step B. and Step C: Identification of actual and potential IROs as well as assessment and determination of the material IROs

113. Identification and assessment of impacts can be challenging for those parts of the VC where the undertaking is not able to trace 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.
114. The undertaking should aim to gather reliable data from actors in its VC, when inclusion of VC information is needed according to ESRS 1.65. 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 and national authorities, newspaper articles, databases, etc. used to estimate the IROs where this provides relevant and faithfully representative information.

Assessment of the involvement of the undertaking with the VC

115. The undertaking is required to provide a description of the material impacts, risks and opportunities connected to it, as well as those that are directly linked to its operations and services in its upstream or downstream value chain (ESRS 2 SBM-3 paragraph 48 (a)).
116. As explained in [MAIG, FAQ 2 What is meant by the undertaking being 'connected' with an impact?](#) 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 with cases of labour rights abuse.



117. The contribution to the impacts in the VC may 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 result from the use of its products, such as oil and gas derived from fossil fuels, plastics contributing to microplastics pollution, cigarettes, or pesticides.
118. An undertaking can cause, contribute or be directly linked to an impact in the value chain. Distinguishing the type of involvement is important given that it could lead to a different assessment or categorisation of the negative impact.

Environmental topical standards on the materiality assessment

119. Environmental standards use the concept of life cycle or life cycle assessment, which also covers value chain, in the context of the materiality assessment. In particular:
- (a) ESRS E2 AR 18: 'In order to assess materiality, the undertaking may consider Commission Recommendation (EU) 2021/2279 on the use of the Environmental Footprint methods to measure and communicate the life cycle environmental performance of products and organisations.'
 - (b) ESRS E3 AR 14: 'The undertaking may rely on primary, secondary or modelled data collection or other relevant approaches to assess material impacts, dependencies, risks and opportunities, including Commission Recommendation 2021/2279 on the use of the Environmental Footprint methods to measure and communicate the life cycle environmental performance of products and organisations (Annex I - Product Environmental Footprint; Annex III - Organisation Environmental Footprint).'
 - (c) ESRS E5: the concept of 'life cycle' is so important that it is part of the objective in paragraph 3 and AR 6, which explain its use in assessing IROs in own operations and the VC.

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

120. 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 of the materiality assessment.

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

121. ESRS 2 paragraph 5(c) requires disclosing to which extent the sustainability statement covers the undertaking's upstream and downstream VC. Therefore, in addition to metrics, this applies to all the steps listed 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 coverage mapping'

122. 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 in the description of its VC:



- (a) the main features of its upstream and downstream VC;
 - (b) the undertaking's position in its VC; and
 - (c) the description of the main business actors and their relationship to the undertaking, including:
 - (i) key suppliers,
 - (ii) key distribution channels, and
 - (iii) key customers and/or end users.
123. Identifying the key actors requires judgement to reflect the specific circumstances of the undertaking's VC and should involve consideration of both impact and financial materiality criteria.
124. The mapping of the VC for material impacts is expected to use the sustainability due diligence process when it 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.

IRO-1 - VC considerations in MA

125. Subsequently, the undertaking shall describe its materiality assessment process, including in relation to the VC, and the extent to which it may be informed by the due diligence process.
126. ESRS 2 IRO-1 paragraph 53 (b)(ii) requires an overview of the process to identify, assess and prioritise the impacts that the undertaking is involved in 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 the undertaking's business relationships in the VC. In fact, the business relationships in the upstream and downstream VC shall also be considered in the context of assessing the materiality of risks and opportunities and not just for impacts (ESRS 1 paragraph 66).
127. A disclosure that meets these requirements could be structured as follows:
- (a) the types of VC relationships that were considered in the materiality assessment;
 - (b) the methods that the undertaking used; and
 - (c) the sustainability topics that were evaluated.
128. For impacts, based on the initial mapping the undertaking may focus on areas where actual or potential impacts could arise, which in turn reflect areas where 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; and
 - (b) on areas of heightened risk of adverse impacts, affected stakeholder engagement and prioritisation based on criteria of severity and likelihood.



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

IRO-1 – MA methods and assumptions

130. ESRS 2 IRO-1 requires information on methods and assumptions applied in the materiality assessment (ESRS 2 paragraph 53(a)), including thresholds, to assess 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

131. As a result of the materiality assessment, the undertaking shall disclose the material IROs originating in 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’.
132. The preparation of this disclosure may use evidence of impacts from the due diligence process, such as the concentration of types of impacts by country or operational step.
133. ESRS 2 SBM-3 also requires describing the material impacts identified following the materiality assessment process disclosed under IRO-1, specifying ‘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)).
134. ESRS 2 paragraph 48(b) requires as well disclosure of ‘the current and anticipated effects of [the undertaking’s] 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’.
135. This implies that when strategically important hotspots for VC IROs have been identified, ESRS 2 SBM-3 requires information about discussions of the impacts at the relevant managerial level or governance bodies in charge (paragraph 48(b)).
136. The disclosures should be consistent with the corresponding information on whether and how the VC was considered in the materiality assessment.
137. The information required by ESRS 2 SBM-3 paragraph 48(a)(b) (such as the effects on and changes in the VC, the undertaking’s business strategy and how it responds or plans to respond to those effects) should enable an understanding of the undertaking’s basic ability to influence those IROs and any potential effects on the undertaking.
138. 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 their likelihood and/or to track the effectiveness of actions to manage them.



FAQ 5: How are investees treated under ESRS E1?

139. The VCIG refers to the terms associates, joint arrangements, joint operations, control, joint control, investment entity, significant influence and joint ventures, having as a reference the definitions per IFRS Accounting standards. Similar concepts exist in local GAAP in EU countries, but the specifics may differ.

140. The table below illustrates the treatment of impacts arising from investments of the undertaking depending on their accounting treatment in the financial statements.

	Common characteristic(s)	Accounting treatment ⁴	Measuring impacts by metrics in E1 standard
Subsidiaries	Control (as defined in IFRS 10)	Include 100% of assets, liabilities, equity, income, expenses and cash flows ⁵	Fully included (scope of consolidation is the same as financial reporting)
Associates	Significant influence (as defined in IAS 28)	The investment is recognised as a single line item on balance sheet (cost adjusted for post-acquisition changes in the investor's share of net assets). The investor's profit or loss and other comprehensive income include its share of the investee's profit or loss and other comprehensive income	<ul style="list-style-type: none"> • operational control: GHG emissions to the extent of operational control (ESRS 1 paragraph 67). • associates that are actors in the value chain (purchases/sales with the investing undertaking): impacts connected to the undertaking's products and services through transactions; <i>and / or</i> • associates with other business relationships (i.e., investees) as for investments below.
Joint ventures	Joint control (as defined in IFRS 11) with rights to the net assets of the arrangement	Same as for associates	Same scenario as for associates ⁶
Joint operations	Joint control (as defined in IFRS 11) with rights to	Recognise its assets, liabilities, revenue,	The assets/liabilities of the joint arrangement

⁴ Please note that this is a very simplified description of the financial reporting requirements (and may differ between IFRS and local GAAP standards used in European countries) and thus does not capture the nuances involved in classifying investments. For the actual definitions and accountant principles, please refer to the legal texts.

⁵ Except for an investment entity (as defined in IFRS 10) which shall measure an investment in a subsidiary at fair value through profit or loss.

⁶ Operational control can also apply to assets under joint control. The related GHG emissions then reflects the terms and conditions of the arrangement.



	Common characteristic(s)	Accounting treatment⁴	Measuring impacts by metrics in E1 standard
	the assets and obligations for the liabilities relating to the arrangement	expenses, including any share from items held jointly	consolidated by the reporting undertaking form part of own operations. In addition, where the reporting undertaking has operational control over its joint operators' assets, these will be included under E1 paragraph 50(b)
Investments	All other investments (in the scope of IFRS 9)	Recognised at fair value; dividends in profit or loss; changes in fair value are recognised in profit or loss or in other comprehensive income	No specific indications in ESRS E1 metrics on how to measure impacts connected with the undertaking through its investments (except for category 15 of GHG Protocol)



FAQ 6: Reporting perimeter for ESRS E1 in practice

141. The following example of the corporate reporting of a fictional group, Seren, has been inspired in the GHG Protocol reporting standard, pages 22 and 23.

142. Seren Group has a number of subsidiaries, joint arrangements and associates who are active in the production and marketing of chemicals. Its group structure and investments are as follows:

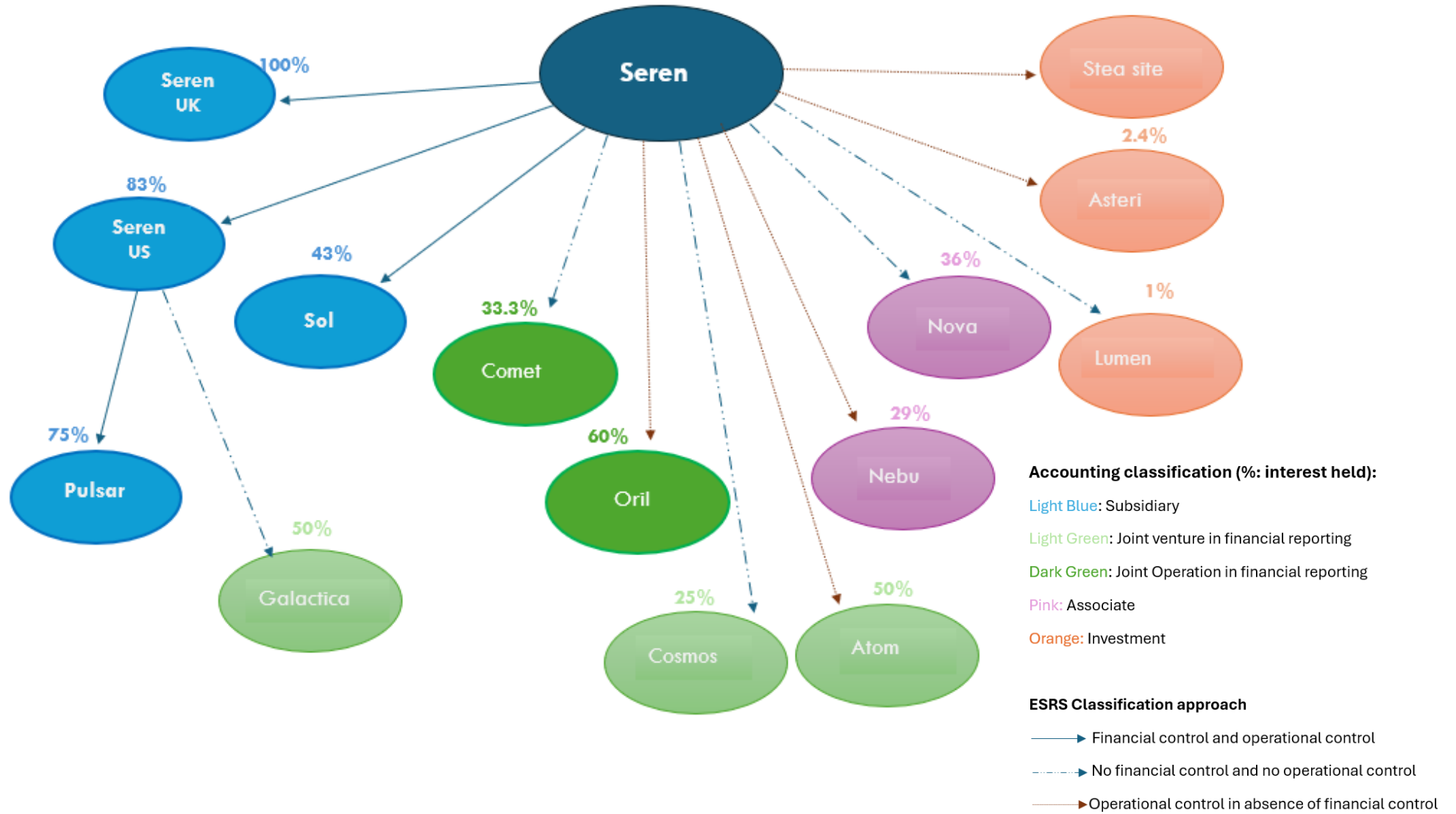
- a. A wholly owned subsidiary, Seren UK. As Seren is the parent of Seren UK for financial reporting purposes, it also controls its operational policies.
- b. A subsidiary called Seren US, which has 17% held by outside shareholders. Seren holds 83% of the shares.
- c. Seren US has a 75% stake in Pulsar, its subsidiary for financial reporting purposes. Ultimately, its operational policies are determined by Seren (Seren has operational control).
- d. Galactica, a 50-50 joint arrangement between Seren US and Estrella classified as a joint venture under IFRS 11 Joint Arrangements. Seren's share of Galactica's emissions are regarded as significant for the purposes of the GHG protocol. (Seren does not have operational control).
- e. Seren holds a 43% stake in Sol, which it calls a joint venture with Alexa. However, Sol is classified as a subsidiary of Seren for financial reporting purposes.
- f. Seren has joint control of Comet (33.3% stake) with two other parties. It is classified as a joint operation under IFRS 11. One of the other joint operators has operational control. Seren's share of emissions are regarded as significant. (Seren does not have operational control).
- g. Seren has a 60% stake in Oril but share joint control with its partner. Oril is classified as a joint operation under IFRS 11, and Seren is an operator of Oril. (Seren has operational control).
- h. Seren also has joint control of Cosmos with three other parties. Cosmos is classified as a joint venture under IFRS 11, with Seren sharing the net assets of Cosmos. The emissions are regarded as significant. (Seren does not have operational control).
- i. Seren has joint control of Atom with another party. Atom is classified as a joint venture under IFRS 11, with Seren sharing the net assets of Atom. In this case, Seren has operational control over Atom. (Seren has operational control).
- j. Nebu, an associate for financial reporting (IAS 28 *Investments in Associates and Joint Ventures*) where Seren has operational control. Seren holds 29% stake. (Seren has operational control).



- k. Seren holds 36% of Nova's shares and has classified it as an associate for financial reporting purposes. Nova has control over its own operations. (Seren does not have operational control).
- l. Seren holds 1% of Lumen's shares. Seren's share of emissions are regarded as insignificant (Seren does not have operational control).
- m. Seren is the operator of Company X's subsidiary, Asteri, in which Seren also holds 2.4%. (Seren has operational control.)
- n. Finally, Seren operates the Stea site owned by Company X. (Seren has operational control.)

143. The figure below depicts Seren Group, whereas the table following it sets out the reporting under ESRS and the GHG Protocol as well as how these entities impact Seren's profit before taxation.





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144. The GHG emissions reporting under the GHG Protocol and ESRS would be as follows.

	Entity	Interest held	Control of operational policies	Other details	Operating profit under IFRS (financial statements)	GHG Protocol emission reporting ⁶			ESRS	Comment
						Equity share approach	Financial control	Operational control		
a	Seren UK	100%	Seren	Wholly owned subsidiary	100% included	100%	100%	100%	100%	Scope 1 or 2 (E1 par. 50(a))
b	Seren US	83%	Seren	Subsidiary	100% included	83%	100%	100%	100%	
c	Pulsar	75%	Seren	Subsidiary of Seren US	100% included	62.25% ¹	100%	100%	100%	
d	Galactica	50%	Estrella	JV of Seren US with Estrella	50% included as income from joint venture	41.5% ²	0	0	50% ³	Scope 3 Investment
e	Sol	43%	Seren	Subsidiary	100% included	43%	100%	100%	100%	Scope 1 or 2 (E1 par. 50 (a))
f	Comet	33.3%	Rain	Joint operation under joint control	Share of revenue/expenses from its assets/liabilities	33.3%	0	0	33.3% ⁴	
g	Oril	60%	Seren	Joint operation under joint control	Share of revenue/expenses from its assets/liabilities	60%	0	100%	100%	Scope 1 or 2⁵
h	Cosmos	25%	Other	Joint venture under joint control	25% as income from JV	25%	0	0	25%	Scope 3 Investment
i	Atom	50%	Seren	Joint venture under joint control	50% as income from JV	50%	0	100%	100%	Scope 1 or 2 (E1 par 50 b)
i	Nebu	29%	Seren	Associate, Seren's OC	29% as income from associate	29%	0	100%	100%	Scope 1 or 2 (E1 par 50 b)
k	Nova	36%	Nova	Associate under IAS 28	36% as income from associate	36%	0	0	36%	Scope 3 Investment
l	Lumen	1%	Quasar	Subsidiary of X	Dividends and fair value changes	0	0	0	0% ⁷	
m	Asteri	2.4%	Seren	Subsidiary of X, Seren is operator (i.e. OC)	Revenues from activities as operator and dividends etc.	0 ⁸	0	100%	100%	Scope 1 or 2 (E1 par 50 b)
n	Stea site	-	Seren	Site where Seren has operational control	Revenues from activities as operator	0	0	100%	100%	



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Legend:

1: 83% x 75.

2: 83% x 50.

3: Without transactions between Galactica and Seren, reported as Scope 3 category 15: 100% (reflecting control over Seren US) x 50.

4: Seren will reflect the emissions from its own assets and operations used in the joint operation.

5: Seren will reflect 60% of Oril's emissions as own operations under paragraph 50(a) and 40% under paragraph 50(b) (operational control).

6: Grey cells come from GHG Protocol or are derived from it. For other colours, please refer to paragraph 145 below.

7: Regarded as not significant.

8: Accounted for as Scope 3 (Investment) proportionate to the stake in the company (2.4%).



145. On the previous page under ‘Comment’, where the cells are white, this reflects Scope 1 and Scope 2 emissions as per paragraph 50(a) of ESRS E1. Where the cells are yellow, these are Scope 1 and Scope 2 emissions as per paragraph 50(b) of ESRS E1, i.e., those items not under financial control but under operational control. Lastly, the green cells reflect Scope 3 emissions.
146. With the yellow cells, the emissions will be reported by the owner under paragraph 50(a) of ESRS E1 as well as by the operator or person with operational control under paragraph 50(b) of ESRS E1. Preparers are free to provide additional context about these emissions, especially in the context of policies, actions and targets.

FAQ 7: Numerical example of GHG emissions under ESRS E1 reporting

147. Company A is a global fashion company.
148. Company B is a producer of fabrics and has a GHG emissions total of 100,000 metric tons (scope 1,2 and 3). How should GHG emissions be accounted for in Company A’s consolidated sustainability statement in each of the following circumstances?
- (a) A has operational control over B, and for financial reporting purposes Company B is a subsidiary of Company A. Scope 1 and Scope 2 emissions of B amount to 90,000 metric tons⁷.
 - (b) A does not have investment in B and does not exercise operational control over B. Company B is a supplier of fabrics, and 80% of the fabrics produced by Company B are supplied to Company A. Therefore, A and B have sales/transactions with each other. It is assumed that category 1 (emissions from purchased goods and services) is significant for company A.
 - (c) Company A holds a 30% ownership share in Company B, and for financial reporting purposes, is an associate of Company A. Company A does not have operational control or transactions with B (i.e., only the investment in equity). The Scope 1 and Scope 2 emissions amount to 90,000 metric tons, and it is assumed scope 3 emissions category 15 (emissions from investments) is significant for company A.
149. Ignoring any complexities around allocation or non-production-related emissions, Company A would report the following in its consolidated sustainability statement with respect to Company B in each of the above scenarios. Note that the scenarios are independent from each other.

Scenario	GHG emissions under ESRS E1	Scope/Category	ESRS reference
a) Operational control	90, 000 metric tons	Scope 1 or Scope 2	ESRS E1 par. 50(a)
	10, 000 metric tons	Scope 3 per category reflecting Company B operations	ESRS E1

⁷ The outcome would be the same even if Company A did not have operational control over Company B, as in ESRS E1 the emissions of the subsidiaries are included irrespective of having operational control over them.



Scenario	GHG emissions under ESRS E1	Scope/Category	ESRS reference
b) Transactions (VC)	80,000 metric tons	Scope 3 Category 1: emissions from purchased goods	ESRS 1 par. 67, E1 par. 51
c) Only investments	27,000 metric tons	Scope 3 Category 15: emissions from investments	ESRS E1 par. 51

150. Please note that under any of the other environmental standards (e.g. E2 Pollution), ESRS do not describe how to report under the third scenario.
151. If A would want to explain its Scope 3 emissions under the financial control approach of the GHG Protocol, its disclosure would include the comment that ESRS E1 has an additional disclosure about this special type of emissions, which would be in Scope 3 under the GHG financial control approach. Conversely, if it wanted to also reflect the GHG Protocol disclosures under the operational control approach, it could use ESRS but would need another amendment to reflect those items under financial control where it does not have operational control.

FAQ 8: How should the impacts resulting from business relationships be assessed and quantified?

152. As set out in the [MAIG FAQ 10 Should the assessment of IROs rely on quantitative information?](#) where qualitative analysis is sufficient for the undertaking to reasonably conclude that a matter is 'not material', adding quantitative information to the analysis would not bring much value to the materiality assessment, where the undertaking has this data due to its sustainability and management practices as well as its engagement with suppliers.
153. The materiality assessment regarding the upstream value chain may be validly conducted by large undertakings without direct information from specific suppliers. Undertakings reporting under the sector-agnostic standards may typically conduct the assessment using average regional or sector data to characterise the areas of potential impacts and risks associated with their value chain.
154. As mentioned above, the materiality assessment process evolves over time, and the undertaking may be redefining the balance between qualitative and quantitative information. Please refer to the [MAIG Chapter 3.6 Deep dive into impact materiality - Setting thresholds](#).
155. For the materiality assessment and for the inclusion of VC data required by metrics (such as for Scope 3 GHG emissions and other entity-specific disclosures when appropriate), the undertaking may either obtain information directly from actors in its VC, use estimates or proxies, or combine both approaches.
156. 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.

157. It should be noted that the more severe the impact, the stronger the incentive to omit such sensitive information, and this could impact the reliability of the information provided by such supplier. This may be particularly relevant for incidents of child or forced labour in the VC.
158. Apart from this issue, the reliability of information directly obtained from the VC may improve over time since VC actors may not be able to quantify their impacts yet but may be in the position to do so in the future, given the evolution of sustainability reporting. Therefore, supporting such actors to set up effective systems may be important. It may also be advisable to engage with them and, where relevant, to also encourage them to do the same with their value chains.
159. Generally, the effort placed on actors in the VC should be proportionate and, as mentioned above, undertakings do not have to report on each and all value chain actors.
160. As set out in ESRS 1 paragraph 69 and further explained under [FAQ 9 How can estimates about the VC be developed?](#) the undertaking shall estimate the impact when it cannot collect the necessary data with the required reliability after reasonable effort when necessary. Estimates and proxies may be used in combination with information obtained directly as well as when quantification is required. Using estimates, like in 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 the unreasonable efforts required to collect data. Examples include tier 2 or tier N suppliers; tier 1 suppliers when they are excessively high in number; and 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).
161. An example where obtaining primary data may not be possible and estimates may be used is a beverage company that advises its drinks to be served cold, i.e., by 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, the average time in which the inventory will be cooled before consumption and an estimate of the average electricity used to cool its products on a unit basis. This may need to also consider the location and related prices. 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 calculations. 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.
162. 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 9: What is 'reasonable effort' to collect VC data?

163. When inclusion of VC information is necessary under ESRS 1 paragraph 63 or on an entity-specific basis, a reporting entity collects information about its upstream and downstream VC only to the extent that this is compatible with a reasonable effort (ESRS 1 paragraph 69) for use in its sustainability statement. 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 AR 17). This includes estimates, sector-average data and other proxies. For example, an undertaking could use country and/or 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 made available. Also refer to paragraph 161 on the need to comply with the quality of characteristics requirement.
164. The undertaking should determine the best available way to prepare meaningful VC information and dedicate proportionate resources once the degree of difficulty has been properly assessed.
165. 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. 'Reasonable effort' and 'undue cost or effort' relate to the processes put in place by the undertaking to collect VC information and the amount of resources dedicated to these processes. 'Reasonable effort' cannot be an excuse for not disclosing. 'Reasonable effort' and 'undue cost and effort' depend on facts and circumstances specific to the undertaking. On the basis of [FAQ 7](#) above, 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/or beyond 'undue cost and effort', 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. The estimation procedures adopted by the undertaking when direct data are not used are subject to ESRS 2 paragraph 10.
166. For VC data, a good starting point is a deep understanding of what, where and how inputs for its products and/or services are sourced upstream and/or what, where and how its products and services are brought to market downstream.
167. 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. In such cases, the undertaking may use other sources of information. For example, an undertaking may have a major exposure to forced labour because it is getting significant volumes of agricultural commodities and products from jurisdictions where forced labour in agriculture has been documented by the ILO (the International Labour Organisation) and the FAO (the Food and Agriculture Organization of the UN). For the materiality assessment, it is not necessary for the undertaking to change practices and estimate the number of cases of child or forced labour in its value chain. What is important is that it has enough information to conclude that the impacts are severe (based on scale, severity and irremediability).



168. Similarly, undertakings calculating their full environmental footprint may use estimates not only because it would be unreasonable to get primary data but also because such data would not be reliable.
169. In the context of materiality assessment, the focus on the VC and VC information should be where the undertaking is expected to have a 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 else being equal.
170. For its own governance as well as for purposes of an audit trail for its assurance provider, it would be good for the undertaking to document its efforts, the outcomes of these and how the information has been incorporated in its reporting process. (Refer also to [MAIG FAQ 12 Should the materiality assessment be documented/evidenced?](#))

FAQ 10: How can estimates about the VC be developed?

171. As discussed in paragraph 28 above, primary VC information is not required for all disclosures in the sustainability statement. Where the undertaking determines that VC information is required and primary data (i.e., directly collected from the actor in the VC) is not available after making reasonable efforts, estimated data can be used.
172. In estimating the missing information, ESRS require 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 data (i.e., directly collected from the actor in the VC) and estimated data (using secondary data as input) can be employed.
173. Secondary data include data from indirect sources, sector-average data, sample analyses, market and peer groups data, other proxies and spend-based data.

Examples of external data sources

- Academic institutions such as the Environmental Performance Index
- Government bodies such as the European Social Progress Index of the European Commission and the US Department of State’s Social Progress Index
- [ILO social protection](#) by country
- Non-profit organisations such as the World Justice Project and other NGOs

174. The adjacent text box lists 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 and human rights as well as corruption matters.

175. It is difficult to collect VC information necessary to produce the relevant disclosure about impacts caused by indirect business relationships where the undertaking does not have a direct contractual relationship and enjoys less leverage. If the undertaking cannot collect the necessary data after making

reasonable efforts 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.

176. Disclosing quantitative measures of indirect impacts does not produce relevant information about the undertaking's impacts in all circumstances. Consider a manufacturer of bike parts who uses steel in its products and therefore has an issue with pollution generated by its steel production. It is theoretically possible to estimate the volume of pollution/quantify the environmental footprint, as some have done. However, this may not be necessary and would not be conducive to relevant information, as it would fail to disclose on the undertaking's contribution to mitigating the pollution that derives from its products. The undertaking could instead measure its performance in terms of ESRS E5 metrics on circular economy.
177. When a reporting entity does not have 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 on facilities in very high-risk countries, including beyond the first tier of business relationships.
178. As set out in AR 73 of ESRS S1 *Own workforce*, the WageIndicator is indicated as a potential source (along with others) for calculating adequate wage benchmarks outside the EEA as the last option in the hierarchy. The WageIndicator provides information about minimum and living wages for more than 200 countries, which could be an example of applicable benchmarks as referred to under ESRS S1-10 *Adequate wages*. 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 become part of the undertaking's explanation under ESRS 2 SBM-3 on how it identified and assessed material IROs. The exact living wages may differ in certain facilities and are dependent on the composition of the worker's family; however, these sources can be useful in the context of the materiality assessment. Once wage has been identified as a material risk, more accurate data may be needed to set targets and to report on progress.
179. Where deemed relevant, undertakings need to consider that setting up a reliable data collection system which includes VC partners takes time. They may consider processes and controls to collect the data and report the information. 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. As mentioned in paragraph 28 above, information about each and every actor in the VC is not required.
180. The use of appropriate estimates or proxies is critical for the quality of reported information. The origin of the data may influence the quality of the information provided in the sustainability statement. Therefore, transparent disclosure and explanation of the use of estimates are essential.
181. 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) describe the resulting level of accuracy; and,



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

FAQ 11: Is a case of bribery not involving an employee relevant for the reporting entity?

182. 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, 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 coverage map

183. The table below maps the disclosure requirements in the sector-agnostic ESRS and that cover the VC.

184. The VC coverage map of Set 1 shown below does not include 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 offer users an understanding of 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 ESRS Set 1

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 VC .	SBM-1 [▫]				
3. The undertaking shall describe its material IROs and report where in the VC they arise	SBM-3 [▫]				
4. The undertaking shall reflect whether and how policies, actions or targets (PAT) cover VC.	BP-1/2 [▫] , SBM-2, GOV-4/5	E1-2 to E1-4 E2-1 to E2-3, E3-1 to E3-3,	E4-1 to E4-4, E5-1 to E5-3, S1-1 to S1-5	S2-1 to S2-5 S3-1 to S3-5 S4-1 to S4-5	G1-1, G1-2, G1-3
5. The standard covers PAT for IROs that are linked to people in the VC . The undertaking shall disclose whether and how PAT cover VC.	S2 S3 ⁸				
6. The disclosure only reflects own operations , as no coverage of VC is required.	GOV-1/3, IRO-2, E1-5	E1-8 -E1-9, E2-4 [▫] , E2-6,	E3-4/5 E4-5/6 E5-4 par. 31	E5-6 S1-1 to S1-17 ⁹	G1-4 to G1-6
7. Disclosure of procured materials .	E2-5 [▫]				

⁸ The standard ESRS S3 *Affected communities* covers a group of people who may also be part of the undertaking’s upstream and downstream VC when they also have business relationships with the undertaking.

⁹ Some consider DR S1-7 as requiring information about the VC; however, these employees are part of own workforce and therefore own operations.



Level of VC coverage	Disclosure Requirements with this level of VC coverage		
8. There are specific quantitative datapoints in this DR that require VC coverage ¹⁰	E1-6		E1-7
9. There are specific qualitative datapoints in this DR that require VC coverage ¹¹ .	E1-1 E4-1 par. 13	E4 IRO 1 par 17(a) E4-4 par. 32(c)	E5-4 par. 30
10. SFDR indicators ¹² listed in ESRS 2 Appendix B.	VC to be covered to the extent contemplated in the relevant technical standards		
11. Other EU law (excluding SFDR) in ESRS 2 Appendix B.	VC covered when required by relevant regulation.		

185. The above table should be read with the following additional notes for those DRs marked with the following symbol: ▫

DR	Contents
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: <ul style="list-style-type: none"> i. identify the metrics; ii. describe the basis for preparation, per E4-1 paragraph 13; iii. describe the resulting level of accuracy; and, iv. where applicable, describe the planned actions to improve the accuracy in the future.
SBM-1	Requires that value chain be covered but is not expected to trigger data requests for actors in the value chain - i.e., can be covered by internal or public information.
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 impacts through its activities or because of its business relationships.
E2-4	AR 20 refers to procurement of microplastics.
E2-5	Relates to the products/materials and/or substances procured which ends up in products/manufacturing.
E5-5	Includes supplied material but does not expand to suppliers and waste treatment; it may sometimes require information from supplier who treats waste

186. Per paragraph 72, for material IROs where the undertaking has policies, actions and targets in place covering the VC, it should disclose this (ESRS 2 paragraphs 64(b), 67(b) and 70(b)). If not, either because the undertaking does not have such PAT or because these do not cover the VC, the undertaking will comply by indicating this.

187. The names of the disclosure requirements are provided in Appendix A.

¹⁰ Coverage of VC information does not necessarily mean collection of data from actors in the value chain. See paragraphs 152 to 155 above.

¹¹ Coverage of VC information does not necessarily mean collection of data from actors in the value chain. See paragraphs 152 to 155 above.

¹² The SFDR regulation is open for consultation, and changes may follow.



Appendix A: Names of disclosure requirements

188. The list of names of the disclosure requirements below is to help in the use of the VC coverage map.

ESRS 2 - General disclosures
DR 2-BP-1 - General basis for preparation of the 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 E2-6 - 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
- 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, approaches to mitigating material risks and pursuing material opportunities related to own workforce, and the 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, approaches to managing material risks and pursuing material opportunities related to value chain workers, and the 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, approaches to managing material risks and pursuing material opportunities related to affected communities, and the 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, approaches to managing material risks and pursuing material opportunities related to consumers and end users, and the 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

