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ESRS Due Diligence – Issue Paper

1. Objective

- 1 The objective of this paper is to discuss the feedback received in the public consultation and propose changes to the ESRS EDs on Due Diligence by the SRT, GRI and public consultation.
- 2 The focus of this paper is Due Diligence across Social standards (i.e. ESRS S1-S4) and the related due diligence principles and disclosures in ESRS 1 and ESRS 2. It has relevance for the disclosures regarding the due diligence process for undertakings that have been embedded across various standards, however, the focus here is the due diligence process for social and human rights factors.

2. Background

2.1 CSRD Provisions

- 3 The CSRD Article 19 b) 2) e) defines the following requirements regarding the information that undertakings are to include in the management report to understand the undertaking's impacts on sustainability matters:

“[...]”

(e) a description of:

(i) the due diligence process implemented by the group with regard to sustainability matters, and where applicable in line with EU requirements on undertakings to conduct a due diligence process;

(ii) the principal actual or potential adverse impacts connected with the group's **own operations and with its value chain, including** its products and services, its business relationships and its supply chain, **actions taken to identify and track these impacts, and other adverse impacts which the parent undertaking is required to identify according to other EU requirements to conduct the due diligence process;**

(iii) any actions taken **by the group**, and the result of such actions, to prevent, mitigate, **remediate or bring an end to** actual or potential adverse impacts. “

- 4 Recital 27 defines the international instruments that the ESRS are to be aligned with and it also defines the aspects to be covered in the due diligence process:

“To ensure consistency with international instruments such as the UN Guiding Principles on Business and Human Rights, **the OECD Guidelines for Multinational Enterprises** and the OECD Due Diligence Guidance for Responsible Business Conduct, the due diligence disclosure requirements should be specified in greater detail than is the case in Article 19a(1), point (b), and Article 29a(1), point (b) of Directive 2013/34/EU.”

- 5 Additionally, Recital 27 defines the concept: *“Due diligence is the process that undertakings carry out to identify, track, prevent, mitigate, remediate and bring an end to the principal actual and potential adverse impacts connected with their activities and identifies how they address those adverse impacts. Impacts connected with an undertaking’s activities include impacts directly caused by the undertaking, impacts to which the undertaking contributes, and impacts which are otherwise linked to the undertaking’s value chain. The due diligence process concerns the whole value chain of the undertaking including its own operations, its products and services, its business relationships and its supply chains. In alignment with the UN Guiding Principles on Business and Human Rights, an actual or potential adverse impact is to be considered principal where it measures among the greatest impacts connected with the undertaking’s activities based on: the gravity of the impact on people or the environment; the number of individuals that are or could be affected, or the scale of damage to the environment; and the ease with which the harm could be remediated, restoring the environment or affected people to their prior state.*

2.2 Due diligence in the current ESRS

- 6 ESRS 1 Chapter 2.5 Due Diligence under the CSRD provides a description as to how the main aspects of due diligence are embedded in the ESRS.
- 7 ESRS 2- GOV – 5 Statement on due diligence requires an undertaking to “disclose its general assessment regarding how it embeds the core elements of due diligence in its sustainability statements” and its application guidance includes a tabular format for undertakings to report the due diligence process.
- 8 The table below illustrates the location of the due diligence disclosures:

Due Diligence	ESRS 1 / 2	ESRS S1-S4
Embed responsible business conduct into policies and management systems	ESRS 2 – GOV	DR 1 – Policies DR 4 - Targets
Identify and assess	ESRS 2 – IRO 1, 2, 3	AG for ESRS 2

Cease, prevent and mitigate		DR 1, 2, 5
Track implementation and results		DR 4
Communicate how impacts are addressed	The ESRS are a basis for communication and dialogue with stakeholders	
Provide for or cooperate in remediation when appropriate		DR 5

3. Structure of this paper

- 9 This paper has been structured in two subsections based on the nature of the public consultation comments received:
- (a) Section 4: Alignment with international standards (including comparability concerns); and
 - (b) Section 5: Architecture: due diligence within the ESRS (including Appendix C of ESRS 1t)
- 10 Each section has a symmetric structure: 1) feedback from the public consultation, 2) EFRAG Secretariat analysis, and 3) drafting proposals (including options, where applicable).

Section 4. Alignment with international standards

4.1 Feedback from the public consultation

Aligning with international standards

- 11 General.** Various stakeholders highlight that the ESRS are not fully aligned with the key concepts and terms contained in international standards, notably the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidance for Responsible Business Conduct. The importance of alignment was emphasised by most if not all leading business and human rights organisations, as well as by other organisations. Many stakeholder comments request additional guidance or clarity relating to due diligence. Some comments received on this point also refer to remediation and grievance mechanisms.
- 12** Examples of such views include that ESRS 1 section 2.5. should describe DD under the CSRD, the disclosure principles 1-1 to 1-3 are related but slightly different from DD as it is defined in the UNGPs and OECD Guidelines and referenced in ESRS 1 para 85-91.
- 13** An additional view is that the disclosure principles (ESRS 1 para 96-106) and the social standard DRs 1-5 currently diverge, and there is a need to be aligned fully with the five steps of DD as described in the OECD DD Guidance for Responsible Business Conduct.

- 14 **ESRS S1-S4:** There was a suggestion to restructure and reword S1-S4 in order to better align with DD and international standards.
- 15 **Remedy, grievance and Concern mechanism.** ESRS S1-4 DR 3 “concern channels” are not fully aligned with the Grievance Mechanism principles of the UNGPs (29, 31), for example that a grievance mechanism needs to be equitable and rights-compatible. The feedback proposes that the connection to remedy should be made explicit. The aspects to be analysed for the remedy connection have been described in the paragraphs below.
- 16 The concept of remedy is key in international standards, and closely connected with due diligence. Whereas it is mentioned in various instances in the ESRS S1-4, it is not given sufficient weight in the current standards to reflect its prominence in international standards. Remedy is not only a human right in itself, but also a fundamental pillar of international standards of corporate responsibility for human rights. Additionally, remedy is relevant beyond the concern channels, in and of itself.
- 17 Whilst concern channels are the place where stakeholders can lodge complaints or raise concerns, remediation is the solution to the harm that has been caused. The connection between remedy and processes for remediation, including concern / grievance mechanism should be clarified.
- 18 **Engagement with affected stakeholders.** ESRS 1 para 88 describes how engaging with stakeholders disclosure requirements have been embedded within the ESRS. Specifically, these are explicitly addressed within ESRS 2-IRO-1 para 74 c) for the first step of due diligence regarding identifying and assessing. DR1-DR6 in the Social standards also include reporting on stakeholder engagement. Whilst ESRS 2 includes disclosures regarding the views, interests and expectations of stakeholders only in relation to the undertaking’s business model and strategy and for a description of stakeholders and their views, interests and expectations ‘as analysed during the undertaking’s own materiality assessment process’. However, the CCS do not currently include a disclosure requirement on how an undertaking identifies its affected stakeholders in relation to impacts, risks and opportunities, or its general approach to engagement with affected stakeholders.
- 19 **Clarifying the fundamental status of ILO core labour rights.** Respondents describe that there is a risk of undermining the core labour rights standards (child labour, forced labour, discrimination, collective bargaining, health and safety) by dividing rights and topics in S1 and S2 (para 2) under “new” headings of working conditions, equal opportunities and “other” work-related rights.
- 20 **Clarifying the relationship between Materiality assessment and Due Diligence.** According to respondents, ESRS 1 and 2-IRO DRs need to be better aligned with international standards. Also clarification should be made that the materiality assessment should be based on an undertaking’s Due Diligence, that disclosures of the materiality assessment should be made both at the cross-cutting level and in relation to each of the topical standards.
- 21 Some stakeholder views state that the DD process is that of assessing and prioritising impacts for action and the materiality assessment process of identifying material impacts is for disclosure; and therefore the former is the source for the latter. By not drawing clear links between the identification phase of DD and the assessment of impact materiality, the ESRS risks the development of parallel processes to satisfy reporting requirements in ESRS 2 DR 2-GOV-5, was the view of some stakeholders.
- 22 Various stakeholders note that whilst ESRS 1 paragraphs 63 to 65 do establish a correct principle that the lack of hard data concerning the value chain does not relieve the undertaking from the disclosure obligations specified in the ESRSs, there is an important difference to note between approximation of value chain-related

data, whose collection is challenging, such as the calculation (environmental) impact indicators. For example, Scope 3 on the one hand; and the identification and assessment of actual and potential impacts along the value chain on the other as a form of risk assessment. It would be inappropriate to consider the identification of actual and potential impacts from a data approximation perspective. That assessment needs instead to be driven by relevant DD guidance in international standards. On the same topic, one stakeholder stated that assessments should be driven by DD in line with international standards. It would be inappropriate for companies to approximate risks, impacts and opportunities of the value chain on the basis of peer or sector comparisons.

- 23 A respondent's view is that paragraphs 64 and 66 of the Application Guidance currently fail to articulate the relationship between the due diligence process of assessing and prioritising impacts for action and the materiality assessment process of identifying material impacts for disclosure (aligned with UNGPs and GRI Universal Standards).

Comparability

- 24 Respondents from the public question describe that there are different uses of the term Due Diligence between the European legal frameworks and domestic laws, EU Sustainability Taxonomy Minimum Safeguards, draft EU Corporate Sustainability Due Diligence Directive and various domestic legislations containing requirements on due diligence, such as in Germany, Norway and France. Therefore, the suggestion being that the CSRD must harmonise the use of terms, not least to ensure consistency in the requirements. Compliance with and reporting under other EU frameworks and domestic regulation must be comparable.
- 25 Various stakeholders point out that there is a **need for consistent use** of the definition of due diligence between and within all parts of the ESRS standards; the social standards, CCS and application guidance. Various stakeholders perceive that there is a lack of clarity with regard to the relationship between the DD process and the materiality process.
- 26 A large group of respondents concluded that there was a need to align key concepts notably due diligence and value chain but also others, with international standards (UNGP's and OECD guidelines).

4.2 Analysis from EFRAG Secretariat

Alignment with international standards

- 27 The ESRS need to be aligned with key concepts in international standards (UNGP's and OECD guidelines), most importantly due diligence, as per the text of the final CSRD. This would include enhancing or clarifying wording in the cross-cutting standards, certain areas in the S1-4 and enhancing guidance where due diligence is referenced. Therefore a series of amendments are proposed to clarify its meaning, and its connection to the reporting requirements. In addition, as per the public consultation feedback received and detailed above, there is also a need to harmonise the use of other terms, including remediation, grievance mechanism.
- 28 With regard to the scope of Due Diligence within the value chain, we note that a separate issue paper has been drafted to cover the approach on the value chain. It is noted that the need to align its content with international standards, UNGP's and

OECD Guidelines in particular is important, notably that there is an expectation that undertakings should report on how they address high risks and severe impacts in the value chain.

Comparability

- 29 The ESRS need to align with other key legislative frameworks, notably the Sustainability Taxonomy minimum safeguards and the upcoming Corporate Sustainability Due Diligence Directive (draft). The best way to ensure alignment with these, is to firstly complete the alignment with international standards (since the normative sources are the same namely the UNGPs and the OECD Guidelines), and secondly to monitor the status and content of the parallel legislative processes in the EU. Aligning with international standards will also increase the possibility to ensure comparability between ESRS and domestic compliance requirements based on due diligence.

Harmonisation of terms within ESRS

- 30 The alignment of key concepts with international standards will reduce the amount of inconsistencies within the ESRS (between CCS, S1-4 and relevant parts of the application guidance) also pointed out by stakeholders in the consultation.
- 31 With regards to tracking performance, the CSRD in its Article 19 a 2 b) requires time-bound targets on sustainability matters; hence, the inclusion of targets within the implementation pillar. Additionally, targets could suitably be connected with the DD step of tracking effectiveness (S1-5). Therefore, no further action on that point.

More guidance, consistency and clarity

- 32 Due diligence reporting requirements are currently dispersed between the ESRS 1-2 and ESRS S 1-4. The application guidance contains various pieces of guidance on due diligence, importantly Appendix C. It is difficult for users of the standards to see the process of due diligence in its entirety, and therefore greater clarity is to be sought.
- 33 Adding this clarity would facilitate the reading and understanding of the due diligence components of the CSRD. The ESRS should also add clarity on the difference and overlaps between the impact materiality process and the DD process. Such connection is well described with Appendix C which is one of the anchor points between the two intertwined concepts and it also provides the guidance requested by preparers, especially those that are reporting on DD for the first time.
- 34 It is also suggested that the status of core labour standards is clarified by putting emphasis on the status of these rights, in one of the application guidance paragraphs under S1-S4 or basis for conclusions.

2.4 Drafting proposals

- 35 The proposal for redrafting to address the public consultation comments can be split into the following four areas:
- (a) Aligning due diligence with international standards;
 - (b) Remedy;

- (c) Clarifying the relationship between materiality assessment and due diligence; and
- (d) Engagement with affected stakeholders.

(a) Aligning due diligence with international standards

36 At cross-cutting level, ESRS 1 should be enhanced as follows:

Current ESRS 1	Drafting proposal
<p>ESRS 1 para 49:</p> <p>Impact materiality is a characteristic of a sustainability matter or information in relation to an undertaking. A sustainability matter is material from an impact perspective if it is connected to actual or potential significant impacts by the undertaking on people or the environment over the short-, medium- or long-term.</p> <p>This includes impacts directly caused or contributed to by the undertaking in its own operations, products or services and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain, and not limited to contractual relationships.</p>	<p>Impact materiality is a characteristic of a sustainability matter or information in relation to an undertaking. A sustainability matter is material from an impact perspective if it pertains to significant actual or potential impacts on people or the environment that are connected to an undertaking's operations, products or services, whether over the short, medium or long term.</p> <p>This includes impacts directly caused or contributed to by the undertaking's own activities, and impacts which are otherwise directly linked to its operations, products or services by its business relationships. Business relationships include those in the undertaking's upstream and downstream value chain and are not limited to contractual relationships.</p> <p><i>GRI proposal:</i> A sustainability matter is material from an impact perspective if it is connected to actual or potential significant impacts by the undertaking on people or the environment over the short-, medium- or long-term. This includes impacts directly caused or contributed to by the undertaking in its own operations, products or services and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain, and not limited to contractual relationships.</p>
<p>ESRS 1: Appendix A Definitions</p> <p>Due Diligence: Process(es) that the undertaking carries out to identify, assess,</p>	<p>Due Diligence: Process(es) that the undertaking carries out to identify and assess: prevent, mitigate and remediate; track and</p>

<p>prevent, mitigate and remediate the material actual and potential adverse impacts connected with its operations, products or services through its own activities and its business relationships.</p>	<p>communicate regarding the actual and potential adverse impacts connected with its operations, products or services through its own activities and its business relationships.</p> <p>CSRD Recital 27: Due diligence is the process that undertakings carry out to identify, track, prevent, mitigate, remediate and bring an end to the principal actual and potential adverse impacts connected with their activities and identifies how they address those adverse impacts.</p> <p>UN Guiding Principles: '(b) A human rights due diligence process to identify, prevent, mitigate and account for how they address their impacts on human rights;'</p> <p>OECD MNE Guidelines: 'For the purposes of the Guidelines, due diligence is understood as the process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems.'</p>
<p>ESRS 1 para 47</p> <p><i>Paragraph 47:</i></p> <p><i>Impact materiality and financial materiality assessments are intertwined and the interdependencies between the two dimensions should be considered in these assessments. In general, the starting point is assumed to be the assessment of impact materiality, (ADD:) which should be based on an undertaking's due diligence, as a sustainability impact may become financially material when it translates or is likely to translate into financial effects in the short-, medium-, or long-term. In addition, beyond considering the actual and potential financial consequences of its material impacts, the undertaking shall consider how it is affected by sustainability matters which are external to its activities.</i></p>	
<p><i>Paragraph 48</i></p> <p><i>The undertaking shall refer to double materiality for the identification of its principal impacts, risks and opportunities (see chapter Materiality assessment of sustainability impacts, risks and opportunities in ESRS 2). In addition, the terms significant and material have the same meaning when referring to impacts, risks and opportunities in ESRS.</i></p>	

Paragraph

51:

*The materiality of an actual impact is determined by the severity of the impact (scale, scope, and irremediable character); while the materiality (i.e. **REPLACE SIGNIFICANCE WITH MATERIALITY**) of a potential negative impact is determined by the severity and likelihood of the impact. In the case of a potential human rights impact, the severity of the impact takes precedence over its likelihood. (ADD:) *The assessment of materiality should be based on an undertaking's due diligence.**

Paragraph 89

*89. This step of due diligence is reflected in the ESRS 2 Disclosure Requirements IRO whereby the undertaking identifies instances where it is, or is at risk of being, involved with adverse impacts on the environment or people, and then assesses the nature of those actual or potential impacts (their context, causes, severity etc) (ADD:) (ADD:) *This step of due diligence forms the basis of the undertaking's assessment of material impacts.* In addition, in the ESRS 2 Disclosure Requirements SBM, the undertaking shall provide additional information on the results of the assessment of how the undertaking's business model and strategy play a role in creating or exacerbating the identified impacts, and the adopted changes to the business model and strategy. Due diligence is an on-going practice that responds to changes in the undertaking's activities, business model, business relationships, operating, sourcing and selling contexts. It is independent of the undertaking's reporting processes but a source of critical inputs to them.*

- 37 ESRS S1-S4: Restructuring and rewording S1-S4 DRs 1-6 to be better aligned with DD. The drafting proposal has been performed on ESRS S1; however, the proposal apply to ESRS S2-S4 where amendments will be mirrored.
- 38 No drafting proposals for ESRS S1-1 to ESRS S1-6 as part of the alignment with the exception of ESR S1-3 Channels for own workers and workers' representatives to raise concerns, please refer to the Remedy subsection below for the drafting. To note that these disclosure requirements are a combination of impact materiality and financial materiality. For due diligence purposes, we focus on the impact materiality disclosure requirements.

(b) Remedy

- 39 The proposed drafting to address the feedback received on remedy related to ESRS S1-3 Channels for own workers and workers' representatives to raise concerns. Nonetheless, these amendments should be mirrored and tailored for the relevant stakeholder groups, for S2-4.

Current ESRS S1	Drafting proposal in green
<p>Disclosure Requirement S1-3 – Channels for own workers and workers' representatives to raise concerns</p>	<p>Disclosure Requirement S1-3 – <i>Processes to remediate negative impacts and Channels for own workers and workers' representatives to raise concerns</i></p>
<p>para 26</p> <p>The undertaking shall describe:</p> <ul style="list-style-type: none"> (a) the channels it has in place for own workers and workers' representatives to raise their concerns or needs directly with the undertaking; and/or (b) the processes through which the undertaking supports the availability of such channels through the workplace of own workers; and (c) how it monitors issues raised and addressed. 	<p>The undertaking shall describe any policies and commitments it has in place to provide for or cooperate in the remediation of negative impacts on workers in the workforce that the undertaking identifies it has identified it has caused or contributed to:</p> <ul style="list-style-type: none"> (a) describe any approach to identify and address grievances, including the channels it has in place for own workers and workers' representatives to raise their concerns or needs directly with the undertaking and/or grievance mechanisms that the undertaking may have established or participates in; (b) describe any other processes by which the undertaking provides for or cooperates in the remediation of negative impacts on workers in the workforce that it identifies it has caused or contributed to; or any of the processes through which the undertaking supports the availability of such channels through the workplace of own workers; (c) describe, if applicable, how stakeholders who are the intended users of the grievance mechanisms are involved in the design, review, operation, and improvement of these mechanisms; (d) describe, if applicable, how the undertaking tracks and monitors issues raised and addressed, and the effectiveness of the grievance mechanisms and other remediation processes, and report examples of their effectiveness, including stakeholder feedback. <p>An alternative of the drafting could be that the new datapoints c) and d) above are optional</p>

	(i.e. may rather than shall) and the old c) on issues raised and addressed is kept.
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(c) Clarifying the relationship between materiality assessment and due diligence

- 40 To address the feedback regarding the connection between these two processes, the following minor enhancements are suggested for ESRS 2:

Current ESRS 2 - Impact, Risks and Opportunities	Drafting proposal in green
<p>ESRS 2 DR IRO 1: Description of the processes to identify material sustainability impacts, risks and opportunities</p> <p>72. The principle to be followed under this Disclosure Requirement is to provide information (i) on how the undertaking is organising its identification and assessment and (ii) the scope of its identification and assessment of sustainability matters (ADD:) drawing on information around identification and assessment of material impacts risks and opportunities described in the topical standards.</p>	
<p>ESRS 2 DR IRO 2: Outcome of the undertaking’s assessment of material sustainability impacts, risks and opportunities</p> <p>75. The undertaking shall provide a description of the outcome of its assessment processes by reference to mandatory disclosures under ESRS (ADD:) and topical information described in the relevant ESRS.</p>	
<p>76. The principle to be followed under this Disclosure Requirement is to give a clear statement of sustainability matters, as addressed by all ESRS, that are material for the undertaking, and to give relevant explanations on (i) how the undertaking relates to the material impacts, risks and opportunities identified by its assessments, (ADD:) including how the impacts related to the undertakings value chain (ii) when the undertaking has or will put in place initiatives to modify its strategy and business model(s), in order to reduce or eliminate the risk or to benefit from the opportunity and/or in order to prevent and mitigate negative material impacts and enhance positive material impacts (see ESRS 2 Disclosure Requirements SBM 3 and 4), why this was the case and (iii) if and why certain mandatory disclosures are not material under the undertaking’s specific facts and circumstances and therefore disclosed as such.</p>	

(d) Engagement with affected stakeholders

- 41 The following drafting proposals are aimed at addressing the connection with affected stakeholders in ESRS 2 SBM disclosure requirements:

Current ESRS 2	Drafting proposal in green
<p>ESRS 2 DR SBM 2 - Views, interests and expectations of stakeholders</p> <p>36. The undertaking shall describe how the views, interests and expectations of its stakeholders inform the undertaking’s strategy and business model(s).</p> <p>37. The principle to be followed under this Disclosure Requirement is to provide an understanding of how stakeholders’ views, interests and expectations are considered for the undertaking’s decision and evolution of its strategy and business model(s).</p> <p>38. The disclosure required shall include the following information: (a) a summarised description of the undertaking’s key stakeholders and their views, interests and expectations as analysed during the undertaking’s own materiality assessment process; and (b) a description of how the strategy and business model(s) of the undertaking are impacted by these views, interests and expectations, (ADD:) and (c) a description of how the undertaking identifies its affected stakeholders in relation to impacts, risks and opportunities and the undertaking’s general approach to engagement with affected stakeholders as part of its due diligence</p>	

Section 5: Architecture: due diligence within the ESRS

5.1 Public consultation feedback

- 42 With regards to architecture, there were two main pieces of feedback that are analysed in this section:

- (a) Potential relocation of the ESRS S1-4 implementation disclosures (DR1 to DR6) to the cross-cutting standards to: i) avoid duplication across standards; and ii) ensure that the disclosures should not be subject to the rebuttable presumption/ materiality assessment. Such feedback has been received by GRI that assimilates cross-cutting to its universal standards;
- (b) Appendix C of ESRS 1 Explanation on sustainability due diligence. Appendix C is perceived as describing conduct obligations and the suggestion is to remove it as per ESMA comment letter.

5.2 Analysis from EFRAG Secretariat

Potential relocation of the ESRS S1-S4 implementation disclosures to ESRS 2

- 43 GRI has suggested across the ESRS the potential move of a limited number of disclosure requirements which are due diligence based, in the case of Social standards, to ESRS 2 for the two reasons explained in para 42 (a) above.
- 44 Such proposal from GRI would lead to no disclosure requirements on implementation (policies, targets, action plans and resources) in the Social standards. Therefore, the consequences would be as follows:
- (i) Cross-cutting standards would have the disclosure requirements of all implementation measure disclosures with its corresponding guidance. Such layout could avoid duplication but would make the structure of the ESRS more complex as two of three pillars would sit in the cross-cutting standards and the topical standards would only remain for performance indicators.
 - (ii) The CSRD requires policies and actions on material sustainability impacts, risks and opportunities and it defines the social and human rights factors in scope of the ESRS. In addition, the CSRD requires disclosures on the undertaking's due diligence. The CSRD as a mandatory regime with a basis of double materiality is more comprehensive than GRI and, therefore, requires more sustainability information. This option would lead to a concentration of sustainability information in the cross-cutting standard and the equivalent part of the management report with a risk to the logical flow of the current ESRS architecture.
 - (iii) S2-S4 would be eliminated in set 1 as they contain no performance indicators. The risk of this approach is that undertakings might treat the social affected stakeholders as a whole and not consider the specificities of each stakeholder group (and the related AG with examples across S2-S4). The material impacts, risks and opportunities that stem from workers in the value chain, affected communities and consumers and end-users are significantly different and the current standards are drafted to support undertakings reporting on these subtopics for the first time if material.

Appendix C of ESRS 1 Explanation on sustainability due diligence

- 45 Annex C provides an objective explanation of what due diligence is in its entirety, based on international standards (UNGPs, OECD Guidelines). Such Annex was developed to support preparers on the due diligence reporting for the first time and to provide an anchor between the ESRS and the international standards.
- 46 In ESRS 2, disclosure requirement GOV-5 requires a statement of due diligence as requested by the CSRD Art 19a) to undertakings to disclose the due diligence process. In order to fulfil the requirements of ESRS 2-GOV-5 application guidance is required and this was the objective of Appendix C.
- 47 The context of Appendix C is relevant to understand the purpose it fulfils. At the date of issuing set 1 of ESRS, the CSDDD is a draft under discussion therefore, we currently lack European legislation on how to conduct due diligence. Therefore, Appendix C is a temporary solution whilst the CSDDD is finally adopted.
- 48 The options presented by the EFRAG Secretariat to resolve the challenge of removing such Appendix as part of the ESRS (i.e. delegated act) whilst ensuring

that enough guidance is provided to comply with the due diligence reporting requirements is as follows:

Option 1 – Include a clear reference to UNGP and OECD guidelines across the ESRS and eliminate Appendix C from Set 1 (ESRS Delegated act). This could also be combined with a different document of non-mandatory nature (e.g. practice statement) to be issued.

Option 2 - to maintain Appendix C as part of the standards, with a note that it is not intended to provide any additional guidance beyond international standards.

Option 3 - to prepare Application Guidance that cross-references the due diligence process to the relevant paragraphs UNGP and OECD. Such approach has the downside that, shall there be changes to the underlying instruments, the ESRS are subject to those. In addition, the guidance sought by preparers, which has been identified as the main concern from the feedback, would not be provided.

Questions to the EFRAG SR TEG and observers

- 49 Do you agree with the drafting proposals in cross-cutting and ESRS S1-4 to increase the alignment with the international due diligence instruments? Specifically, the decisions related to: i) para 36 on the definition of impact materiality from GRI? Para 36 on the definition of due diligence ?; and para 39 regarding datapoints c) and d) being optional with a 'may'?
- 50 Do you agree with the proposal of not changing the current structure of ESRS S1-S4 whereby the implementation disclosure requirements (i.e. DR1 to DR6) remain at topical level and do not move to ESRS 2?
- 51 With regard to concerns on the removal of Appendix C, which option in paragraph 48 would you support?
- 52 Any other comments?