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Boundaries and Value chain - Issue paper

Objectives of this session

- 1 To discuss, agree upon and recommend to the SRB (i) a transition provision to reflect the changes in the CSRD related to the trickle-down effect and (ii) a way forward in order to address the comments received in the consultation.

Structure of this paper

1. Transition provision to reflect the changes in the CSRD
3. Implementation of the value chain general requirement in ESRS 1 (and clarification of the approximation concept).

1. Transition provision to reflect the changes in the CSRD

- 2 The following transition provision is proposed:
- 3 *For the first three years of the application of this Directive, in the event that not all the necessary information regarding the value chain is available, the undertaking shall explain the efforts made to obtain the information about its value chain, the reasons why this information could not be obtained, and the plans of the undertaking to obtain such information in the future*
- 4 *For 2024, the incorporation of information on impacts, risks and opportunities on matters connected to the undertaking by its direct and indirect business relationships in the upstream and/or downstream (as required by paragraph 64) is not required, except for:*
 - (a) *DRs in topical ESRS that contain datapoints derived from the SFDR PAI;*
 - (b) *ESRS 2, for which undertakings are however allowed to report using solely data available in house*
- 5 *For 2025, the incorporation of information on impacts, risks and opportunities on matters connected to the undertaking by its direct and indirect business relationships in the upstream and/or downstream (as required by paragraph 64) is not required, except for the following:*
 - (a) *DRs in topical ESRS that contain datapoints derived from the SFDR PAI;*
 - (b) *ESRS 2 and DRs on PTAPR in the topical ESRS, for which undertakings are however allowed to report using solely data available in house.*
- 6 *Starting from 2026, undertakings shall incorporate information on impacts, risks and opportunities on matters connected to the undertaking by its direct and indirect business relationships in the upstream and/or downstream, as required by paragraph 64.*

2. Implementation of the value chain general requirement in ESRS 1 (and clarification of ‘approximation’)

- 7 One of the recurring comments in the public consultation has been the difficulty to implement the general principle of value chain in ESRS 1: it is difficult to cover on the entire value chain, the concept is too broad, there is a need to limit the value chain.
- 8 In addition, the risk-based approach (‘where applicable’) has not been widely understood and this may have contributed to the perception of excessive details required.
- 9 Another recurring area of comments has been the concept of approximation: missing detailed guidance (methodology/assumptions) on approximation; there should be a process to move from approximation to real data, approximation should be a temporary solution for undertakings; there should be a clear definition of instances where approximation is allowed; it is inappropriate to use approximations for the identification of actual and potential impacts along the value chain; this should be driven by due diligence guidance.
- 10 Finally, it has observed that the requirement to restate prior period’s information in case of changes to the boundaries (par. 71) goes significantly beyond the requirements for restatement of reported numbers in the financial reporting and would potentially be misleading rather than provide relevant information to adjust number to reflect a structure which did not exist.
- 11 To address the feedback from the consultation, the EFRAG Secretariat considers that there is a need to:
 - (a) clarify the scope of value chain information, reinforcing the concept that undertakings shall include information about the value chain on a risk-based approach (when this is needed in order to provide a faithful representation about material IROs identified in the undertaking’s materiality assessment, which in turn is expected to define the scope of the undertaking’s policies, targets and actions plans);
 - (b) add guidance as to whether and to what extent the undertakings are expected to collect direct data from actors in their value chain to produce this information and introduce the concept of primary as opposed to secondary data;
 - (c) replace the concept of ‘approximation’ with the concept of ‘estimation that rely on secondary data’;
 - (d) next to the existing requirement in ESRS 1 to disclose significant estimation uncertainty, add a requirement to disclose the level of accuracy of the information about the value chain for which the estimate rely on secondary data;
 - (e) add a definition of ‘operational influence’ that is compatible with the due diligence concept of severity for impact materiality; and
 - (f) limit the requirement to restate prior period’s reporting to the financial reporting perimeter and require only an explanation of how significant changes to the boundaries have impacted the information about value chain included in the previous reporting periods.

The following paragraphs focus on the directions to be taken for the additional guidance, on the basis of the current prevailing sustainability reporting practices.

Definition of primary and secondary data

- 12 The primary data are directly obtained from actors of the value chain, such as supplier-specific data meter readings, purchase records, utility bills, direct monitoring, mass balance. The secondary data are obtained by various sources,

such as sector-average data, sample analyses, market and peer groups data, other proxies or spend-based data.

How to operationalise the value chain for the assessment of IROs

- 13 The assessment of the material impacts, risks and opportunities (IROs) is in general performed through qualitative or quantitative methodologies of risk assessment that in many cases do not rely on primary data collected from individual actors of the value chain, such as:
 - (a) Product Life Cycle Analysis for environmental impacts; or
 - (b) Extended Input-Output models for Human Rights exposure; or
 - (c) Peer groups, sector data and similar sources.
- 14 The methodologies described above are reference points for the due diligence process, which drives impact materiality, and its related steps: i) identification (ie screening, high level spotting), ii) assessment (ie qualitative deep dive; and iii) policies, targets and action plans (ie responding to impacts and monitoring performance). Notwithstanding, the specific facts and circumstances of the undertaking that will determine the severity of such impacts should be at the core of the IRO assessment. Similarly, depending on the undertaking facts and circumstances, the due diligence mechanism of stakeholder engagement is expected to be a major source of information.
- 15 Considering the above, for impacts, risks and opportunities, EFRAG Secretariat considers that their identification should cover the broader scope over the value chain, in many cases through the use of estimation based on secondary data, which should be refined over time, and capturing the specific facts and circumstances of the undertaking whilst applying the due diligence process and its severity concept.

How to operationalise the value chain for PTAPR

- 16 Information about policies, targets, actions and resources (PTAPR) is essential for management purposes (i.e. needed in order to manage sustainability matters in business practices). As such, the related information is in many cases available internally, without a specific request to the actors of the value chain. The level of maturity of the policies and actions will be different, as well as the coverage of actors in the value chain. Phase-in (see transition provision above) will allow undertakings to expand the scope of the policies and actions. For PTAPR, the undertaking has access to primary data from actors in the value chain, which is needed primarily for management purposes, as it has contractual relationships or other interactions/engagement with those actors (i.e. actors that are under the operational influence of the undertaking) that can provide leverage to the undertaking. Therefore, reliance is to be placed on “undertaking’s own data or in-house data” to the extent that PTAPR represent the management approach over its value chain (for example, the undertaking’s policy objectives to its value chain management). To note that the requirements on policies (Disclosure principle 1) for example, do not require the undertakings to disclose the actual policies of the undertaking’s value chain parties and, hence, it limits the data to be required from the value chain entities on this regard.
- 17 The scope of the policies may differ: in many cases policies are designed to address the full value chain, but they may actually be signed only by tier 1 partners. For targets and actions, the starting point in many cases is on partners for which the undertaking has the current ability to influence their operations (possible definition of ‘operational influence’) as only in those cases the undertaking’s actions could be effective. In this context, operational influence covers a variety of contractual situations, such as: tier 1 strategic suppliers, customers and partners, JV and

Associates, franchisees, outsourced or insourced operations, independent sales force, etc.

- 18 Outside the operational influence, the undertaking may not have the ability to collect primary data. However, despite the absence of a direct contractual relationship or other interactions, the undertaking may still have access to the relevant information. For example, in specific sectors, databases are available on suppliers in the sector or there is a generally accepted certification standard. More guidance can be developed in sector-specific ESRS.
- 19 In order to consider both the circumstances (operational influence that allows to have direct access to primary data or existence of other sources that allow to have indirect access to primary data), the concept of 'operational influence' could be replaced by the concept 'current ability to have direct or indirect access to primary data of actors in the undertaking's upstream or downstream value chain'.
- 20 Considering the above, for policies, targets, actions and resources (PTAPR), EFRAG Secretariat considers that in many instances the information will come from inside the undertaking (as it is normally collected for management purposes and it is accessible as the undertaking has contractual relationships or other interactions/engagement with actors in the value chain) or, depending on the sector, it may be derived from indirect sources.

How to operationalise the value chain for performance measures

- 21 The quantitative performance indicators aim at monitoring the progresses. In many cases, the KPIs are focused on boundaries that are well controlled, such as own operations or non-employees working on the undertaking's sites for health & safety.
- 22 For performance indicators, EFRAG Secretariat considers that information includes own operations (for which the level of accuracy is higher), but shall be expanded unless impracticable with direct or indirect primary data of actors in the value chain that are under operational influence and, where applicable, with the use of secondary data beyond the operational influence. The use of secondary data is intended to be limited to instances where the collection of primary data is impracticable, i.e. when the entity cannot collect them after making every reasonable effort to do so. For example, such estimates based on secondary data could be practical when value chain entities are not under the scope of the CSRD.
- 23 As any other information presented in the sustainability statements, the estimate of a given KPI that includes value chain in its scope of calculation has to meet the general characteristics of quality, including reliability, defined in Chapter 2.1 of ESRS 1. Undertakings shall use appropriate methodologies and estimation processes to ensure that, when the estimate relies on the use of secondary data (in absence of primary data), the results are reliable. The level of accuracy in this case will be lower than when an estimate is produced using direct data. Disclosing the level of accuracy of the information about the value chain for which the estimate rely on the use of secondary data is a relevant information for users and, as such, a specific requirement should be added in ESRS 1 (similar to the requirement to disclose significant measurement uncertainties).
- 24 As an overall example, scope 3 GHG emissions are approximated and used firstly to identify where reductions should be achieved in priority and where risks may come from. Secondly, the policies and actions may involve the tier 1 suppliers when if the undertaking's purchasing power is sufficient. Lastly, scope 3 may be used to monitor the improvement depending on the influence of the undertaking. When the undertaking has a certain level of operational influence, targets on scope 3 may be relevant but the uncertainties of the calculation may be significant, sometimes even greater than the reduction target. As an example, a semi-conductor manufacturer may not be able to account for the GHG emissions of the end products its chips are

incorporated in, when he doesn't know what their final use will be. Appropriate application guidance will be detailed in sector specific ESRS to identify whether and to what extent full coverage of the value chain should be considered.

- 25 Another example on human rights or corruption risks lead to the same conclusion. Human rights or corruption risks are usually identified through risk mapping activities. These risk mappings usually cross internal data on expenses or sales with country or sector statistical risks data or databases. Media review and whistleblowing channels analyses are also good sources. Policies coverage are usually general but commitments, if any, are only made by actors under operational control. When it comes to actions, they are designed to prevent the risks and to address the hotspots (a specific supplier in a given country in relation with a specific risk). For these very limited number of cases, an audit or a dialogue may be implemented. The performance indicators might in this case be the number of hotspots identified or solved, or the number of reported allegations received through whistleblowing channels. These KPIs would be based on internal data and do not require external direct data requests to actors of the value chain.
- 26 In relation to human rights and social factors disclosures, a number of stakeholders noted in the public consultation that whilst ESRS 1 paragraphs 63 to 65 do establish a principle that the lack of hard data concerning the value chain does not relieve the undertaking from the disclosure obligations specified in the ESRS, there is a nuance to be considered. These respondents described an important difference to note between approximation of value chain-related data, whose collection may be challenging, such as the calculation (environmental) impact indicators, e.g. 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. And these concluded that for the identification of actual and potential impacts within the value chain, data approximations would not be the solution to data collection gaps. That assessment needs instead to be driven by relevant DD guidance in international standards (i.e. namely stakeholder engagement with the individual stakeholders or collectively) to identify the severe material IROs which are specific to the undertaking rather than peer or sector comparisons.
- 27 In conclusion: expanding the reporting boundary to include information about the undertaking's upstream and downstream value chain is not always expected to be based on primary data. Direct data collection of primary data from the actors of the value chain beyond first tier or beyond operational influence is not necessary in order to integrate entities of the value chain into the reporting boundaries in ESRS.

Proposed re-drafting

Reporting boundary

63. An entity's sustainability statements shall be for the same reporting entity as the related financial statements. ~~The undertaking's reporting boundary for its sustainability reporting is the one retained for its financial statements.~~ For each of the entities included in the sustainability statements, the reporting boundary is expanded, where applicable, to its upstream and downstream value chain. Associates and joint ventures accounted for under the equity method are considered as part of the upstream or downstream value chain. Entities accounted for under the proportional consolidation method are considered as part of the boundary for the consolidated portion.

*64. The undertaking's reporting boundary is expanded when the integration of information on **material** impacts, risks and opportunities on matters connected to the undertaking by its direct and indirect business relationships in the upstream and/or downstream value chain is necessary to:*

(a) allow users of sustainability reporting to understand the undertaking's material impacts and how material sustainability-related risks and opportunities affect the undertaking's development, performance and position; and

(b) produce a set of complete information that meets the qualitative characteristics of information quality (see chapter 2.1 Characteristics of information quality).

65. When determining at which level (within its own operations and its upstream and downstream value chain) a material sustainability matter arises, the undertaking shall leverage and rely on its assessment of impacts, risks and opportunities following the double materiality concept (see chapter 2.2 Double materiality as the basis for sustainability disclosures). In particular:

(a) The impact materiality of a sustainability matter should be based on due diligence and is not constrained to matters that are within the undertaking's direct control, but is determined by:

i. the severity of the impact (actual or potential)

ii. evidence of a link between the impact and the undertaking's own operations, products and services, including through its downstream and upstream value chain; and

(b) Where an impact is severe, the undertaking shall report on the efforts undertaken to obtain sufficient information about the situation, to enable a suitable response to the impact or risk in line with due diligence requirements of UNGPs and OECD Guidelines.

(c) The financial materiality of a sustainability matter is not constrained to matters that are within the control of the undertaking. In reporting about sustainability matters that are considered financially material, the undertaking shall also include risks and opportunities (including those arising from dependencies) and outcomes attributable to or associated with other undertakings/stakeholders beyond the scope of financial reporting that have a significant effect on the ability of the undertaking to create value.

Use of all the reasonable and supportable information ~~including primary and secondary peer group or sector data~~

67. In some circumstances, collecting the information about the undertaking's upstream and downstream value chain that is needed to integrate entities in the value chain into the reporting boundary as required by paragraphs 63 and 64 may be impracticable, i.e. the undertaking cannot collect the necessary ~~primary data information~~ after making every reasonable effort. In these cases, the undertakings ~~shall estimate the information to be reported seek to approximate the missing information~~ about its upstream and downstream value chain, by using all reasonable and supportable information, including internal and external information, such as ~~peer groups or sector data~~ secondary data. For example, ~~this could be the case for value chain entities that are not in the scope of the CSRD.~~

68. When doing so, it shall also disclose: the relevant information and indicators for which secondary data ~~have an approximation has~~ been used, and the planned actions to reduce the missing data in the future.

Operational influence over activities and relationships in the upstream and downstream value chain

69. The undertaking's level of operational influence on entities involved in its upstream and downstream value chain and the level of access to their sustainability-related information may vary, depending on the undertaking's position in the value chain. The undertaking's contractual arrangements, its buying power (for direct suppliers), and the effectiveness of its own systems, among other factors, influence the level of access to the relevant information. As regards policies, targets, actions, action plans, resources, and quantitative performance measures, it is more likely that the undertaking will have access

to information in relation to entities under its operational influence belonging to either its upstream or downstream value chain. However, the undertaking shall make every reasonable effort to obtain relevant data from entities under its operational influence, as well as from entities beyond its operational influence and shall disclose a clear indication of the **accuracy of the estimations made using secondary data.** ~~approximations made.~~ **The incorporation of estimations made using secondary data shall not result in information that does not meet the qualitative characteristics of information quality (see chapter 2.1 Characteristics of information quality).**

70. The undertaking's boundary is expanded to its upstream and downstream value chain, following the provisions in paragraphs 63, 64 and 65, in particular where severe impacts may arise regardless of the level of control or influence.

In order to incorporate, where appropriate, the information about the undertaking's value chain when reporting on:

- a) material impacts, risks and opportunities, an undertaking is not expected to collect primary data from actors of their upstream and downstream value chain in all circumstances;**
- b) policies, targets, actions and resources, an undertaking may use information already available in its management processes and/or, derived from indirect sources (such as public databases about suppliers or similar sources), when the information derived from the indirect sources is substantially equivalent to the information collected from actors of the value chain;**
- c) performance measures, an undertaking is not expected to collect primary data from the actors of the value chain beyond the first tier or beyond operational influence in all circumstances.**

66. When a topical or sector-specific ESRS requires that a disclosure requirement is prepared using a specific reporting boundary, the topical or sector-specific requirement shall prevail.

Reporting policy adopted for the definition and changes of reporting boundaries

71. The undertaking shall, on a regular basis, reassess the definition of its reporting boundaries, to make sure it remains appropriate. When a change has occurred in the undertakings' boundaries, such as a change in its legal or operational structure or its products and services, business relationships and supply chain, the definition of the reporting boundaries shall be adjusted accordingly. To facilitate the understanding of the undertaking's performance and developments, it shall:

- a) restate the comparative information related to the financial reporting perimeter; and**
- b) disclose an explanation of how significant changes to the boundaries have impacted the information about value chain included in the previous reporting periods., unless the undertaking assesses that this is impracticable, after making every reasonable effort.**

ESRS 2 - Disclosure Requirement 2-GR 5 – Using **secondary data approximations on the disclosure in relation to boundary and value chain**

23. Following the principle on boundaries and value chain of ESRS 1 when the undertaking has used **estimation based on secondary data** ~~peer group information or sector data to missing data~~ due to impracticability of collecting primary data about value chain, it shall disclose:

- (a) its basis for preparation for the relevant disclosure and indicators, including the scope for which an estimation based on secondary data ~~approximation~~ has been used *and the level of accuracy of the estimate*; and
- (b) the planned actions to reduce missing data in the future.

Appendix A

<i>Operational influence</i>	<i>Current ability of the undertaking to influence the operations of actors (individuals and undertakings) in its upstream and downstream value chain.</i>
<i>Primary data from actors in the value chain</i>	<i>The primary data are directly obtained from actors in the value chain, such as supplier-specific data meter readings, purchase records, utility bills, direct monitoring, mass balance.</i>
<i>Secondary data about the value chain</i>	<i>The secondary data about the value chain are obtained by various indirect sources, such as sector-average data, sample analyses, market and peer groups data, other proxies or spend-based data.</i>

Questions to SR TEG

- 28 Do you agree with the proposed approach and drafting of the transition provision?
- 29 Do you agree with the EFRAG Secretariat conclusions with reference to IFRS S1?
- 30 Do you agree with the proposed approach and re-drafting of the value chain paragraphs in ESRS 1? Specifically, how the concept of operational influence and due diligence interact in the assessment of IROs when value chain data cannot be collected?

Appendix 1 ESRS 1 ED

Reporting boundary

63. The undertaking's reporting boundary for its sustainability reporting is the one retained for its financial statements expanded to its upstream and downstream value chain. Associates and joint ventures accounted for under the equity method are considered as part of the upstream or downstream value chain. Entities accounted for under the proportional consolidation method are considered as part of the boundary for the consolidated portion.

64. The undertaking's reporting boundary is expanded when the integration of information on impacts, risks and opportunities on matters connected to the undertaking by its direct and indirect business relationships in the upstream and/or downstream value chain is necessary to:

- (a) allow users of sustainability reporting to understand the undertaking's material impacts and how material sustainability-related risks and opportunities affect the undertaking's development, performance and position; and
- (b) produce a set of complete information that meets the qualitative characteristics of information quality (see chapter 2.1 Characteristics of information quality).

65. When determining at which level (within its own operations and its upstream and downstream value chain) a material sustainability matter arises, the undertaking shall leverage and rely on its assessment of impacts, risks and opportunities following the double materiality concept (see chapter 2.2 Double materiality as the basis for sustainability disclosures). In particular:

- (a) The impact materiality of a sustainability matter is not constrained to matters that are within the undertaking's direct control, but is also determined by:
 - i. evidence of a link between the impact and the undertaking's own operations, products and services, including through its downstream and upstream value chain; and
 - ii. the relative severity of the impact.

(b) The financial materiality of a sustainability matter is not constrained to matters that are within the control of the undertaking. In reporting about sustainability matters that are considered financially material, the undertaking shall also include risks and opportunities (including those arising from dependencies) and outcomes attributable to or associated with other undertakings/stakeholders beyond the scope of financial reporting that have a significant effect on the ability of the undertaking to create value.

66. When a topical or sector-specific ESRS requires that a disclosure requirement is prepared using a specific reporting boundary, the topical or sector-specific requirement shall prevail.

Use of all the reasonable and supportable information including peer group or sector data

67. In some circumstances, collecting the information about the undertaking's upstream and downstream value chain that is needed to integrate entities in the value chain into the reporting boundary as required by paragraphs 63 and 64 may be impracticable, i.e. the undertaking cannot collect the necessary information after making every reasonable effort. In these cases, the undertakings should seek to approximate the missing information about its upstream and downstream value chain, by using all reasonable and supportable information, including internal and external information, such as peer groups or sector data.

68. When doing so, it shall also disclose: the relevant information and indicators for which an approximation has been used, and the planned actions to reduce the missing data in the future.

Operational influence over activities and relationships in the upstream and downstream value chain

69. The undertaking's level of operational influence on entities involved in its upstream and downstream value chain and the level of access to their sustainability-related information may vary, depending on the undertaking's position in the value chain. The undertaking's contractual arrangements, its buying power (for direct suppliers), and the effectiveness of its own systems, among other factors, influence the level of access to the relevant information. As regards policies, targets, actions, action plans, resources, and

quantitative performance measures, it is more likely that the undertaking will have access to information in relation to entities under its operational influence belonging to either its upstream or downstream value chain. However, the undertaking shall make every reasonable effort to obtain relevant data from entities under its operational influence, as well as from entities beyond its operational influence and shall disclose a clear indication of the reliability of data obtained and approximations made.

70. The undertaking's boundary is expanded to its upstream and downstream value chain, following the provisions in paragraphs 63 and 64, regardless of the level of control or influence.

Reporting policy adopted for the definition and changes of reporting boundaries

71. The undertaking shall, on a regular basis, reassess the definition of its reporting boundaries, to make sure it remains appropriate. When a change has occurred in the undertakings' boundaries, such as a change in its legal or operational structure or its products and services, business relationships and supply chain, the definition of the reporting boundaries shall be adjusted accordingly. To facilitate the understanding of the undertaking's performance and developments, it shall restate the comparative information, unless the undertaking assesses that this is impracticable, after making every reasonable effort.