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

Log of draft explanations

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ID 166 – Scope of the consolidation timing of acquisitions and divestments

[**For SRB to note:** TEG as well as SRB WG members agreed with the answer of this ID, but some pointed out the practical difficulties that undertakings have following the current ESRS requirements for acquisitions close to year-end, also noting that pointing to estimates is not helpful especially if those estimates do not meet the requirements for quality of information ('badly estimated metrics'). An Amendment to ESRS was considered necessary by many.]

Question asked

In case an undertaking acquires/divests from one or more of its subsidiaries, how should the undertaking report on them in the year of acquisition/divestment?

ESRS reference

ESRS 1 paragraphs 33, 62

Key terms

Acquisition and divestment of subsidiaries in the sustainability statement

Background

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

ESRS 1 paragraph 62 states: 'The sustainability statements shall be for the **same reporting undertaking as the financial statements**. For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, the sustainability statement will be for the group.'

ESRS 1 paragraph 102 states: 'When the undertaking is reporting at a consolidated level, it shall perform its assessment of material impacts, risks and opportunities for the entire consolidated group regardless of its group legal structure.'

The consolidated group comprises the parent company and the subsidiaries financially controlled based on IFRS Accounting Standards or the applicable national GAAP. A parent company might acquire control or lose control over a subsidiary during the reporting period. From an accounting point of view, the subsidiary is consolidated for the first time on the day control is achieved, or de-consolidated on the date control is lost, according to applicable accounting requirements. Under IFRS Accounting Standards, the undertaking has one year to complete the full accounting procedure and at the year-end, pending the completion of the procedure, a provisional accounting approach is taken. ESRS do not have a corresponding provisional reporting approach.

Answer

The sustainability statement shall be for the same reporting undertaking as the financial statements. Therefore, in the approach of the first-time consolidation (deconsolidation) of newly acquired (disposed) entities, the perimeter for the sustainability statement follows the scope and timing applied in the financial statements. This results in a pro-rata inclusion or exclusion of flux metrics (e.g. water consumption, GHG emissions), starting or ending from the date of acquisition to the date of divestment (i.e. the date control is acquired or lost), and a consideration of point-in-time metrics at that specific point in time (e.g. the balance sheet date with the entities acquired, respectively, without the entities disposed of).

If regarding newly acquired subsidiaries the undertaking cannot disclose the information prescribed by either the Disclosure Requirements and datapoints in the topical or sector-specific ESRS or the Minimum Disclosure Requirements in ESRS 2 on **policies, actions and targets** because it has not adopted the respective policies yet, implemented the respective actions yet or set the respective targets yet, it shall – if they relate to a material matter – disclose this to be the case, and it may report a time frame in which it aims to have these in place (see ESRS 1 paragraph 33). However, the reporting undertaking shall disclose the policies, actions and targets adopted by the acquired investee before the acquisition when they were in place in the reporting period to manage material IROs.

Material **metrics** of impacts, risks or opportunities of the acquired investee are to be reported, i.e. included, in the relevant group metrics. If the metric cannot be determined through direct data collection, it shall be estimated; assumptions and limitations in this estimation shall be disclosed.

Similarly to what happens in the preparation of consolidated financial statements, practical considerations might be applied when preparing the sustainability statement, such as not including the data of an acquired entity during the reporting period when the difference in the relevant metrics would be immaterial, provided that the resulting information still allows to meet the qualitative characteristics of information, including relevance and faithful representation (see ESRS 1 paragraph 19).

Sources of estimation and outcome uncertainty shall be disclosed in accordance with ESRS 2 paragraph 11.

See also:

ID 148 Scope of consolidation – non-EU and unconsolidated subsidiaries;

ID 337 Metrics calculation – same level of precision; and

ID 504 Disclosure Requirements on material metrics when information is not available.

For the attention of the SRB

An SRB WG member objected and provided the following rational: 'Material **metrics** of impacts, risks or opportunities of the acquired investee are to be reported, i.e. included in the relevant group metrics. If the metric cannot be determined through direct data collection, it shall be estimated; assumptions and limitations used for this estimation shall be disclosed.'

The member thinks that the above is not always possible or sensible and would prefer to follow the process as described in the following paragraph: 'If regarding newly acquired subsidiaries the undertaking cannot disclose the information prescribed by either the Disclosure Requirements and datapoints in the topical or sector-specific ESRS or the Minimum Disclosure Requirements in ESRS 2 on **policies, actions and targets** … if they relate to a material matter – [it shall] disclose this to be the case and it may report a time frame in which it aims to have these in place (see ESRS 1 paragraph 33).'

As such, the member proposes this edit or rejects this explanation if changes cannot be made.

Feedback from the secretariat: We note the concern and understand the difficulties. The same view has been raised by some in TEG as well. However, ESRS 1 paragraph 33 is only applicable to PAT, so it cannot be extended by analogy to other situations. The concern might result in an amendment of ESRS going forward.

ID 526 and ID 1021 – Disclosure of a non-material datapoint (water-consumption in own operations) related to a (a) material and (b) non-material topic

Category

cross-cutting

Question asked

(1) If water consumption is only **deemed material for the value chain** [and not material to own operations], is the undertaking still allowed to include this datapoint in its sustainability statement?

(2) If water consumption is **not material** for the undertaking (neither in relation to IROs that arise in own operations nor for those that arise in upstream and downstream value chain) but third parties ask the undertaking to include this datapoint in its sustainability statement, is this allowed?

ESRS Reference

ESRS E3 Disclosure Requirement E3-4 (paragraph 28); ESRS 1 paragraphs 11, 31, 33, 34, 114, and QC 17

Key terms

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

Background

EFRAG received two questions that were combined because they are on a similar issue. ID 526 'If water consumption is only deemed material for upstream value chain [and not material to own operations], is the undertaking still allowed to include this datapoint in their report?' and ID 1021 'For a non-material topic, is it allowed to publish metrics that some clients / scoring agencies ask us to include in our sustainability reporting?

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

ESRS 1 paragraph 31: states: 'The applicable information prescribed within a Disclosure Requirement, including its datapoints, or an entity-specific disclosure, shall be disclosed when the undertaking assesses, as part of its assessment of material information, that the information is relevant from one or more of the following perspectives:

(a) the significance of the information in relation to the matter it purports to depict or explain; or
(b) the capacity of such information to meet the users' decision-making needs, including the needs of primary users of general-purpose financial reporting described in paragraph 48 and/or the needs of users whose principal interest is in information about the undertaking's impacts.

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

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

ESRS 1 paragraph 34 states for **metrics**: 'When disclosing information on metrics for a **material sustainability matter** according to the Metrics and Targets section of the relevant topical ESRS, the undertaking:

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

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

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

ESRS 1 paragraph QC 17 states for the qualitative characteristic of 'understandability': '... Concise disclosures shall only include material information. Complementary information presented pursuant to paragraph 114 shall be provided in a way that avoids obscuring material information.'

Answer

(1) If water consumption is only deemed material for the value chain [and not material to own operations], is the undertaking still allowed to include this datapoint in its sustainability statement?

If water consumption is only deemed material in relation to IROs that arise in the upstream or downstream value chain and not in own operations, the most relevant metric to be included is the water consumption for the value chain only. This is not a metric included in the sector agnostic ESRS (ESRS E3 paragraph 24 (a) being focused on own operations). However, even if no data point in ESRS E3 is identified as material, the undertaking shall consider whether this or another metric that depicts this matter shall be disclosed as entity-specific disclosure following ESRS 1 paragraph 11. Reference is made to ID 442 – *Entity-specific metrics*.

As stated in ESRS 1 paragraph 34 (b) in respect of a metrics **for a material sustainability matter** an undertaking '**may omit** the information prescribed by a datapoint of a Disclosure Requirement if it assesses such information to be not relevant based on the ESRS 1 paragraph 31 criteria and concludes that such information is not needed to meet the objective of the Disclosure Requirement.'

The undertaking assesses the datapoint of ESRS E3 paragraph 24 (a) to be not material information. Accordingly, based on ESRS 1 paragraph 34 (b) the undertaking may omit this datapoint even though the sustainability matter water consumption is material.

As ESRS 1 paragraph 34 (b) states that 'the undertaking may omit', this implies that the undertaking **does not have to omit** the datapoint. Put it another way, 'may omit' does not mean 'shall omit'. Therefore, it can be included in the sustainability statement.

In addition, the undertaking shall consider requirements of ESRS 1 chapter 2 *Qualitative characteristics of information* that material information is not obscured by immaterial information.

(2) If water consumption is not material for the undertaking (neither in relation to IROs that arise in own operations nor for those that arise in upstream and downstream value chain) but third parties ask the undertaking to include this datapoint in its sustainability statement, is this allowed?

It depends.

As already clarified in IG 1 Materiality assessment (paragraph 25), following the provisions in ESRS 1 paragraph 114, in addition to the disclosure of material matters identified during the materiality assessment process, the undertaking may provide additional information stemming from other legislation as well as from generally accepted sustainability reporting standards and frameworks (for example, SASB Standards or GRI Standards). This may include additional information that is required by stakeholders and it shall fulfill the criteria laid out in ESRS 1 Appendix B Qualitative characteristics of information. This requires that: ' ... Concise disclosures shall only include material information. Complementary information presented pursuant to paragraph 114 shall be provided in a way that avoids obscuring material information.'

Such information may fall under the remit of ESRS 2 BP-2 paragraph 15 whereby this information 'shall: (a) be clearly identified with an appropriate reference to the related legislation, standard or framework (see ESRS 2 BP-2, paragraph 15).

To note: The undertaking shall consider whether the fact that a third party is asking for information on its water consumption, provides an indication that this is material information.

<u>**Note for the SRB Re answer to question 2:**</u>

An SRB observer suggested to stick to the two categories explicitly stipulated in ESRS 1 paragraph 114, i.e. additional information stemming from:

- other legislation; and
- generally accepted sustainability reporting standards and frameworks (for example, SASB Standards or GRI Standards).

As such, the observer proposes to not include the 'third category' (i.e. additional information that is required by stakeholders) as stipulated in paragraph 25 of IG 1.

The Secretariat tentatively rejected the proposed change considering that reporters may disclose non-material datapoints related to a non-material topic on a voluntary basis in order to meet the needs of stakeholders, which is in line with paragraph 25 of IG 1.

ID 803 – Own operations versus operational control

Category

Cross-cutting

Question asked

What is the difference between 'own operations' and 'operational control' in ESRS?

ESRS Reference

ESRS E1 paragraphs 62 and 63; ESRS E1 paragraphs 46 and 50; ESRS E2 paragraph 29; ESRS E4 paragraph 16

ESRS E3 paragraph 28 (water consumption)

Key terms

Own operations; water consumption and leased property

Background

The submitter provided the following background information along with the question: 'We believe own operations and operational control are separate: operational control is about the authority to implement operating policies, while own operations are about ownership and financial control. To confirm, in ESRS E3, if a company is leasing from a landlord and the landlord is paying the utility bills, does the company report on that water consumption?'

The submitter asked a second question: 'In ESRS E3, if a company is leasing from a landlord and the landlord is paying the utility bills, does the company report on that water consumption?' This question will be addressed in (forthcoming) implementation guidance on leasing.

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

ESRS 1 paragraph 62 states: 'The sustainability statement shall be for the same reporting undertaking as the financial statements. For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, the sustainability statement will be for the group. This requirement does not apply where the reporting undertaking is not required to draw-up financial statements or where the reporting undertaking is preparing consolidated sustainability reporting pursuant to Article 48(i) of Directive 2013/34/EU.'

ESRS 1 paragraph 63 states: 'The information about the reporting undertaking provided in the sustainability statement shall be extended to include information on the material impacts, risks and opportunities connected with the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain ('value chain information'). In extending the information about the reporting undertaking, the undertaking shall include material impacts, risks and opportunities connected with its upstream and downstream value chain:

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

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

ESRS E1 paragraph 46 states (Disclosure Requirement E1-6 – Gross Scopes 1, 2, 3 and Total GHG emissions): 'When disclosing the information on GHG emissions required under paragraph 44, the undertaking shall refer to ESRS 1 paragraphs 62 to 67. In principle, the data on GHG emissions of its associates or joint ventures that are part of the undertaking's upstream and downstream value chain (ESRS 1 Paragraph 67) are not limited to the share of equity held. For its associates, joint ventures, unconsolidated subsidiaries (investment entities) and contractual arrangements that are joint arrangements not structured through an entity (i.e. jointly controlled operations and assets), the undertaking shall include the GHG emissions in accordance with the extent of the undertaking's operational control over them.'

ESRS E1 paragraph 50 states: 'For Scope 1 and Scope 2 emissions disclosed as required by paragraph 44(a)(b), the undertaking shall disaggregate the information, separately disclosing emissions from:

(a) the consolidated accounting group (the parent and subsidiaries); and

(b) investees such as associates, joint ventures, or unconsolidated subsidiaries that are not fully consolidated in the financial statements of the consolidated accounting group, as well as contractual arrangements that are joint arrangements not structured through an entity (i.e. jointly controlled operations and assets), for which it has operational control.'

ESRS E2 paragraph 29 states (Disclosure Requirement E2-4 Pollution of air, water and soil): 'The amounts referred in paragraph 28 shall be consolidated amounts including the emissions from those facilities over which the undertaking has financial control and those over which it has operational control. The consolidation shall include only the emissions from facilities for which the applicable threshold value specified in Annex II of Regulation (EC) No 166/2006 is exceeded.'

ESRS E4 paragraph 16 states (Disclosure Requirement SBM 3 – Material impacts, risks and opportunities and their interaction with strategy and business model): 'The undertaking shall disclose:

(a) a list of material sites in its own operations, including sites under its operational control, based on the results of paragraph 17(a). The undertaking shall disclose these locations by: …'

ESRS E3 paragraph 28 states (water consumption): 'The disclosure required by paragraph 26 relates to own operations and shall include:

(a) total *water consumption* in m3 …'

Note to SRB members

The present draft has been approved by the SR TEG members that attended the meeting in which it was discussed, with the dissent of Julia Kolzer (Allianz). She thinks that the following addition is not strong enough to stress the need for industry-specific principles (e.g. financial institutions): 'Own operations are **usually** understood to correspond to the assets and liabilities included in the consolidated financial statements unless they are not included but there is operational control (limited to E1-6, E2-4, and E4-DR SBM 3). Sector standards may define specific provisions to define own operations and upstream and downstream value chain considering the peculiarity of transactions in that sector. For financial institutions, see ID 41 *Financial institutions – scope of reporting boundary*.'

Answer

Own operations

'Own operations' is not a term defined in ESRS other than not being upstream or downstream value chain (see ESRS 1 paragraphs 62 and 63). Own operations are usually understood to correspond to the assets and liabilities included in the consolidated financial statements unless they are not included but there is operational control (limited to E1-6, E2-4, and E4 Disclosure Requirement SBM 3). Sector standards may define specific provisions to define own operations and upstream and downstream value chain considering the peculiarity of transactions in that sector. For financial institutions, see ID 41 *Financial institutions – scope of reporting boundary*.

Operational control

In the Glossary of ESRS, 'operational control' is defined and its application is further explained in EFRAG IG 2 *Value Chain* Chapter 2.3 as well as FAQs 5 to 7.

Operational control is used in ESRS to include in the measurement of metrics (in ESRS E1 for GHG emissions and in ESRS E2 for pollution) and in the list of material sites in ESRS E4 the information of sites, assets and entities that are under operational control of the undertaking but not recognised in its financial statements. Operational control does not apply to ESRS S1-S4 (see IG 2 *Value chain* paragraphs 60 and 61).

For the measurement of GHG emissions (ESRS E1 paragraphs 46 and 50(b)), the measurement of the amounts of pollutants (ESRS E2 paragraph 29) and the disclosure of the list of material sites in (ESRS E4 paragraph 16 (a)), the information to be reported includes in addition to that coming from own operations the information on sites, assets and entities not included in the consolidated financial statements if the undertaking exercises operational control over them.

Looking at the treatment of GHG emissions from entities, sites and assets not included in the consolidated financial statements but under operational control, which include 'unconsolidated subsidiaries that are not fully consolidated in the financial statements of the consolidated accounting group' when the reporting entity has operational control, ESRS E1 clarifies that they are classified as Scope 1 and 2 (refer to ESRS E1 paragraph 50(b)). In this sense, despite not belonging to the consolidated group (as they are not included in ESRS E1 paragraph 50(a)), still they are not considered as belonging to the upstream or downstream value chain (as they are not in Scope 3), since the undertaking has the ability to direct the operational activities and relationships of the asset/site/undertaking concerned as if they were part of own operations.

Reference is made to IG 2 *Value chain* paragraph 51. Operational control in the case of ESRS E1 does not only relate to investees (associates, joint arrangements and unconsolidated subsidiaries, etc.) under operational control but also to GHG emissions of entities, assets and sites under operational control which are not included in the consolidated financial statements (e.g. when no investment relationship exists between the reporting entity and the asset or site under operational control).

ID 804 – Investment entities - scope of sustainability statements

Category

Cross-cutting

Question asked

Is an entity that qualifies as an Investment Entity as per IFRS 10 required to prepare a sustainability statement with the same consolidation scope as the financial statements?

ESRS Reference

ESRS 1 paragraphs 62 and 102

Key terms

IFRS 10 investment entities; asset managers; scope of consolidation.

Background

ESRS 1 paragraph 62 states: 'The sustainability statements shall be for the same reporting undertaking as the financial statements. For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, the sustainability statement will be for the group. ...'

ESRS 1 paragraph 102 states: 'When the undertaking is reporting at a consolidated level, it shall perform its assessment of material impacts, risks and opportunities for the entire consolidated group regardless of its group legal structure. …'

IFRS 10 *Consolidated Financial Statements* paragraph 4b states: 'A parent that is an investment entity shall not present consolidated financial statements if it is required, in accordance with paragraph 31 of this IFRS, to measure all of its subsidiaries at fair value through profit or loss.'

IFRS 10 paragraph 27 states: 'A parent shall determine whether it is an investment entity. An investment entity is an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.'

IFRS 10 paragraph 31 states: 'Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply IFRS 3 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9.' This exception to consolidation is based on IASB's conclusion that the fair value of the investments provides more relevant reporting of information used by investors in making economic decisions (see IFRS 10 BC 317).

Answer

Note for the SRB:

One Board member objected based on the below rationale.

In Denmark investment entities have the option to prepare their financial statements under:

1. IFRS 10, or
2. Local GAAP requiring full consolidation of all their investments

As currently drafted investment entities choosing the second option would not be able to apply ID 804 but would need to prepare a sustainability statement that is in line with what is in their financial statements.

The Board member would like to broaden the scope of ID 804 to be also applicable to the "local GAAP investment entities".

The Secretariat thinks that the proposal is not in line with what is covered by ESRS 1 para. 62: 'The sustainability statements shall be for the same reporting undertaking as the financial statements. For example, if the reporting undertaking is a parent company required to prepare consolidated financial statements, the sustainability statement will be for the group. ...'

Therefore, the Secretariat tentatively rejected the proposed change.

The Board member stressed that broadening the scope of ID 804 to investment entities in general would be more in line with their business model and would therefore produce better sustainability reporting and would also make reporting in the industry more comparable. Acknowledged – however this would also make any linkage between financial and sustainability statement of those entities impossible.

As this is more than an editorial change, the Secretariat proposes that this matter is discussed in the next SRB (i.e. 13 November).

If the change is accepted, the Secretariat would suggest having this as an IG, as in our view

Yes, provided that the thresholds to prepare a sustainability report are met, and subject to also considering operational control that might result in a different scope as the financial statements for some environmental disclosures.

The sustainability statement shall be for the same reporting undertaking as the financial statements (ESRS 1 paragraph 62). This also applies to investment entities as defined in IFRS 10 paragraph 27 applying IFRS in their financial statements. In accordance with IFRS 10, paragraph 4 b, such investment entities do not consolidate their investment in subsidiaries in their financial statements. However, in the context of sustainability reporting, these investments represent business relationships that expose the undertaking to impacts, risks and opportunities and therefore should be included in the scope of the materiality assessment and sustainability statement as value chain.

For the environmental disclosures that also consider operational control reference is made to ID 803 – *Own operations versus operational control*.

For the consideration of the investments in subsidiaries of investment entities reference is made to IG 2 *Value Chain*: FAQ 2: *Are financial assets (loans, equity, and debt instruments) considered business relationships that trigger value chain information?*

More detailed guidance is expected in future sector standards.

ID 855 – Financial materiality and time horizon

Category

Cross-cutting

Question asked

What is the role of time horizon (short-, medium- or long-term) in the materiality assessment of risks and opportunities?

ESRS Reference

ESRS 1 Chapter 3.5 *Financial materiality;* paragraphs AR 14 and AR 15; Chapter 6.4 *Definition of short-, medium- and long-term for reporting purposes*; ESRS E1 paragraphs AR 67 and 68

Key terms

Time horizon; financial materiality

Background

The question received, 'When assessing risks and opportunities from a financial perspective, how is it possible to integrate the variable of time horizon (e.g. short-, medium- or long-term) in the evaluation of magnitude/probability of that risk or opportunity?' was rephrased to the above for clarity.

ESRS 1 paragraph AR 14 states: 'The **identification** of risks and opportunities that affect or could reasonably be expected to affect the undertaking's financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term is the starting point for financial materiality assessment. In this context, the undertaking shall consider:

(a) the existence of dependencies on natural and social resources as sources of financial effects (see paragraph 50);

(b) their classification as sources of:

  i. risks (contributing to negative deviation in future expected cash inflows or increase in deviation in future expected cash outflows and/or negative deviation from an expected change in capitals not recognised in the financial statements); or

  ii. opportunities (contributing to positive deviation in future expected cash inflows or decrease in deviation in future cash outflows and/or positive deviation from expected change in capitals not recognised in financial statements).'

ESRS 1 paragraph AR 15 states: 'Once the undertaking has identified its risks and opportunities, it shall determine which of them are **material for reporting**. This shall be based on a combination of (i) the **likelihood of occurrence** and (ii) the **potential magnitude** of financial effects determined on the basis of appropriate thresholds. In this step it shall consider the contribution of those risks and opportunities to financial effects in the short-, medium- and long-term based on:

(a) scenarios/forecasts that are deemed likely to materialise; and

(b) potential financial effects related to sustainability matters deriving either from situations with a below the "more likely than not" threshold or assets/liabilities not, or not yet, reflected in financial statements. This includes:

i. potential situations that following the occurrence of future events may affect cash flow generation potential;

ii. capitals that are not recognised as assets from an accounting and financial reporting perspective but have a significant influence on financial performance, such as natural, intellectual (organisational), human, social and relationship capitals; and

iii. possible future events that may have an influence on the evolution of such capitals.'

ESRS E1 paragraph AR 67 states: 67. 'Material climate-related physical risks and transition risks may affect the undertaking's financial position (e.g. owned assets, financially-controlled leased assets, and liabilities), performance (e.g. potential future increase/decrease in net revenue and costs due to business interruptions, increased supply prices resulting in potential margin erosions) and cash flows. The low probability, high severity and long-term time horizons of some climate-related physical risk exposures and the uncertainty arising from the transition to a sustainable economy mean that there will be associated material anticipated financial effects that are outside the scope of the requirements of applicable accounting standards.'

ESRS E1 paragraph 68 states: 'Currently, there is no commonly accepted methodology to assess or measure how material physical risks and transition risks may affect the undertaking's future financial position, financial performance and cash flows. Therefore, the disclosure of the financial effects (as required by paragraphs 64, 66 and 67) will depend on the undertaking's internal methodology and the exercise of significant judgement in determining the inputs and assumptions needed to quantify their anticipated financial effects.'

Answer

Note for the SRB

Note for the SRB

Note for the SRB

An **SRB member** (in the context of the SRB WG) objected and commented that this ID should not be published as an Explanation but as an IG in order to allow stakeholders to provide feedback.

EFRAG SR TEG discussed the need to develop an IG as well but reached a consensus on the

A sustainability matter is material from a financial perspective if it generates risks or opportunities that have a material influence, or that could reasonably be expected to have a material influence on, the undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital **over the short-, medium- or long-term** (ESRS 1 paragraph 49). When assessing a risk or opportunity for (financial) materiality, the undertaking considers the perspective of the investors (ESRS 1 paragraph 48).

The assessment '… shall be based on a combination of (i) the **likelihood** of occurrence and (ii) the potential **magnitude** of financial effects determined on the basis of appropriate thresholds' (see ESRS 1 paragraph AR 15). The consideration of the time horizon is based on the time value of money/the discounted cash-flow method in line with investors' information needs: a cash inflow/cash outflow is worth more/less now than the same cash flow at a future date due to its earnings potential in the interim.

Magnitude

The time horizon may affect the **magnitude** of a financial effect via the discounting of financial effects expected to arise at a future date. Financial effects are generally assessed by investors for their magnitude in terms of net present value.

However, there are cases when effects that are expected to arise in the long term and/or more uncertain financial effects should be assessed based on the undiscounted expected amounts. The longer the time horizon, the more uncertain its outcome. There might be situations when discounting might make figures irrelevant or the financial effects might be – due to their uncertainty of occurrence in either the short-, medium- or long-term – not accessible to discounting (e.g. a flooding in an area exposed to it), but the undiscounted financial effects would nevertheless be relevant for investors. This is also acknowledged in ESRS E1 Disclosure Requirement E1-9 paragraphs 67 and 68 for anticipated financial effects (see above 'Background').

IFRS S1 is also a source of inspiration when considering financial materiality and time horizon. See also IFRS S1 B 24 (cited below, in 'Supporting material'): 'For example, this might happen if information about a particular sustainability-related risk or opportunity is highly scrutinised by primary users of an entity's general purpose financial reports'.

Judgements, estimates and assumptions made when considering the time value of money shall consider connectivity of information (see ESRS 1 Chapter 9.2 *Connected information and connectivity with financial statements*), noting that when measuring assets or liabilities in financial statements time value of money is often considered.

Likelihood

Time horizon may also affect the assessment of **likelihood** of a financial effect. When looking at the likelihood of financial effects, factoring the time horizon may have conceptually different effects.

There are instances where a higher likelihood is associated with a specific time horizon. Consider the risk of impairing an asset due to the end of its useful life for a potential ban of a specific technology starting from a given period in the future. The likelihood of a risk arising might be affected by whether the ban is expected in the near future or further ahead in the future. However, if the ban is already decided (there is no uncertainty), the financial effect is not affected by likelihood (the probability of occurrence is 100%) and the time horizon only affects the magnitude (not the likelihood).

In other instances, the longer the time horizon, the higher the likelihood of an event happening (i.e. the higher the likelihood of the associated risk or opportunity). For example, a flooding or a situation of water stress is less likely to occur during the short-term one-year time horizon as compared to longer mid-term and long-term time horizons.

Supporting material

IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* B19 – B24 states:

'Identifying material information

B19 Materiality judgements are specific to an entity. Consequently, this Standard does not specify any thresholds for materiality or predetermine what would be material in a particular situation.

B20 To identify material information about a sustainability-related risk or opportunity, an entity shall apply, as the starting point, the requirements of the IFRS Sustainability Disclosure Standard that specifically applies to that sustainability-related risk or opportunity. In the absence of an IFRS Sustainability Disclosure Standard that specifically applies to a sustainability-related risk or opportunity, the entity shall apply the requirements on sources of guidance specified in paragraphs 57–58. Those sources specify information, including metrics, that may be relevant to a particular sustainability-related risk or opportunity, to a particular industry or in specified circumstances.

B21 An entity shall assess whether the information identified in applying paragraph B20, either individually or in combination with other information, is material in the context of the entity's sustainability-related financial disclosures taken as a whole. In assessing whether information is material, an entity shall consider both quantitative and qualitative factors. For example, an entity might consider the magnitude and the nature of the effect of a sustainability-related risk or opportunity on the entity.

B22 In some cases, IFRS Sustainability Disclosure Standards require the disclosure of information about possible future events with uncertain outcomes. In judging whether information about such possible future events is material, an entity shall consider:

(a) the potential effects of the events on the amount, timing and uncertainty of the entity's future cash flows over the short-, medium- and long-term (referred to as 'the possible outcome'); and

(b) the range of possible outcomes and the likelihood of the possible outcomes within that range.

B23 When considering possible outcomes, an entity shall consider all pertinent facts and circumstances. Information about a possible future event is more likely to be judged as being material if the potential effects are significant and the event is likely to occur. However, an entity shall also consider whether information about low-probability and high-impact outcomes might be material either individually or in combination with information about other low-probability and high-impact outcomes. For example, an entity might be exposed to several sustainability-related risks, each of which could cause the same type of disruption – such as disruption to the entity's supply chain. Information about an individual source of risk might not be material if disruption from that source is highly unlikely to occur. However, information about the aggregate risk – the risk of supply chain disruption from all sources – might be material.

B24 If a **possible future event** is expected to affect an entity's cash flows, but only **many years in the future**, information about that event is usually less likely to be judged material than information about a possible future event with similar effects that are expected to occur sooner. However, in some circumstances, an item of information could reasonably be expected to influence primary users' decisions regardless of the magnitude of the potential effects of the future event or the timing of that event. For example, this might happen if information about a particular sustainability-related risk or opportunity is highly scrutinised by primary users of an entity's general purpose financial reports.'

ID 870 – Materiality threshold for group company

Category

Cross-cutting

Question asked

Is it technically possible to identify consolidated issues and establish a 'consolidated' materiality matrix for a group comprising several companies operating in various sectors of activity by averaging the issues?

ESRS Reference

ESRS 1 Chapter 3 *Double materiality as the basis for sustainability disclosures* and paragraph 102

Key terms

Consolidated reporting

Background

ESRS 1 paragraph 102 states: 'When the undertaking is reporting at a consolidated level, it shall perform its assessment of material impacts, risks and opportunities for the entire consolidated group regardless of its group legal structure. It shall ensure that all subsidiaries are covered in a way that allows for the unbiased identification of material impacts, risks and opportunities. Criteria and thresholds for assessing an impact, risk or opportunity as material shall be determined based on chapter 3 of this Standard.'

Answer

No, when assessing the materiality of the impacts, risks and opportunities of different subsidiaries operating in different sectors, they should not be averaged but assessed in their own right. This is because the assessment of material impacts, risks and opportunities is agnostic, whether the business activities are conducted in a group comprising several subsidiaries operating in various sectors of activity or whether those same business activities are all conducted by one legal entity that is active in various sectors.

As stated in ESRS 1 paragraph 102, 'when the undertaking is reporting at a consolidated level, it shall perform its assessment of material impacts, risks and opportunities for the entire consolidated group, regardless of its group legal structure.'

In respect of thresholds for impacts, risk or opportunities of subsidiaries operating in various sectors, IG 1 *Materiality assessment* states in paragraph 125: 'When performing the materiality assessment at a group level , paragraph 103 [of ESRS 1] **does not require the adoption for a given sustainability matter of a common threshold** that is the same for the group in its entirety but rather to adopt an approach that is at the same time consistent across the whole group and unbiased, i.e. able to capture the specificities that may exist in a specific subsidiary.'

For matters assessed to be material for some subsidiaries in isolation but not for the group in its entirety, IG 1 *Materiality assessment* states in paragraph 128: 'Conversely, in addition to disclosing information about matters that are material for the group in its entirety, there **may be situations** where a matter is assessed to be material for some subsidiaries in isolation but, despite the aggregation of data of such subsidiaries, the **matter is assessed as not material for the group in its entirety**.'

Reference is made to IG 1 *Materiality assessment* in Chapter 3.6.3 *Consideration for groups and subsidiaries* and FAQ 13: *Performing the impact materiality assessment when the undertaking operates in different sectors*, mentioning a top-down approach and a bottom-up approach or a combination of the two approaches to materiality assessment in group situations.

ID 1013 - Variable remuneration potential discrepancy between ESRS 2 and ESRS E1?

For the attention of SRB

The ESRS E1 requirement is interoperable with its IFRS S2 equivalent. EFRAG Secretariat has confirmed with the ISSB staff that the percentage for the IFRS S2 equivalent shall be calculated on total remuneration.

ESRS E1 paragraph 13 is a specification of ESRS 2 paragraph 29; therefore, the expectation would be (and the intent of the authors of ESRS E1 also was) that the percentage be based on variable remuneration alone contrary to the current wording of ESRS E1 paragraph 13.

TEG considered that it would be best to align ESRS 2 and ESRS E1 trying to avoid creating an issue of interoperability.

Category

Cross-cutting

Question asked

(1) Is the ESRS 2 Disclosure Requirement GOV-3 on 'the proportion of variable remuneration dependent on sustainability-related targets and/or impacts' (ESRS 2 paragraph 29(d)) calculated as a percentage of:

   (a) variable remuneration;

   (b) fixed remuneration; or

   (c) total remuneration (fixed and variable)?

(2) Is the percentage to be disclosed under ESRS E1 Disclosure requirement related to ESRS 2 GOV-3 *Integration of sustainability-related performance in incentive schemes* calculated on the same denominator as under question 1) above?

ESRS Reference

ESRS 2 paragraph 29(d) and ESRS E1 paragraph 13

Key terms

Remuneration; fixed and variable remuneration; annual total remuneration

Background

The question received, 'In the E1.GOV-3_02 requirement, could you please precise whether the required percentage of current remuneration related to sustainability shall be calculated: (i) as a percentage of variable remuneration, (ii) as a percentage of fixed remuneration, or (iii) as a percentage of total remuneration (fixed plus variable)?', has been modified to the above for clarity. The submitter provided the following answer to the question: 'Drawing a parallel between ESRS E1.GOV-3_02 and the ESRS 2 GOV-3_05, I would assume the percentage of current remuneration related to sustainability asked shall be calculated as a percentage of variable remuneration.'

ESRS 2 paragraph 29 states: 'The undertaking shall disclose …

(d) the **proportion of variable remuneration** dependent on sustainability-related targets and/or impacts …'.

ESRS E1 paragraph 13 states: 'The undertaking shall disclose … the **percentage of remuneration** recognised in the current period that is linked to climate-related considerations …'.

Annual total remuneration is defined in Annex II *Acronyms and Glossary of Terms*: 'Annual total remuneration to own workforce includes salary, bonus, stock awards, option awards, non-equity incentive plan compensation, change in pension value, and nonqualified deferred compensation earnings provided over the course of a year.'

Answer

(1) Is the ESRS 1 Disclosure Requirement GOV-3 on 'the proportion of variable remuneration dependent on sustainability-related targets and/or impacts' (ESRS 2 paragraph 29(d)) calculated:

- ***(a) as a percentage of variable remuneration;***
- ***(b) as a percentage of fixed remuneration; or***
- ***(c) as a percentage of total remuneration (fixed and variable)?***

The ESRS 2 paragraph 29(d) metric shall be calculated as (a) a percentage of variable remuneration.

ESRS 2 paragraph 29(d) requires the 'proportion of variable remuneration dependent on sustainability-related targets and/or impacts' to be disclosed. According to this wording, the nominator is the proportion of the variable remuneration dependent on sustainability-related targets and/or impacts, and the denominator is the variable remuneration.

Though not explicitly stated in ESRS 2 Disclosure Requirement GOV-3 (paragraph 29(d)) it shall be assumed that remuneration is the amount recognised in the current period, i.e. the amount recognised as expense (i.e. independent on whether paid out or not) under the applicable accounting GAAP in the financial statements considering connectivity with financial statements in line with the elements listed in the definition of 'annual total remuneration' in Annex II, and consistent with ESRS E1 paragraph 13, which explicitly refers to the 'remuneration recognised'.

(2) Is the percentage to be disclosed under ESRS E1 Disclosure requirement related to ESRS 2 GOV-3* Integration of sustainability-related performance in incentive schemes *calculated on the same denominator as under question 1) above?

No, it is not. The ESRS E1 paragraph 13 metric shall be calculated as a percentage of total remuneration.

ESRS E1 paragraph 13 requires the 'percentage of remuneration recognised' to be disclosed. The phrase used requires that the denominator be the remuneration recognised, accordingly the total of fixed and variable remuneration recognised, and the nominator is the 'remuneration recognised … that is linked to climate-related considerations'.

To note: There is no reason why the term 'remuneration' as used in both ESRS 1 paragraph 29 and ESRS E1 paragraph 13 in respect of the administrative, management and supervisory bodies is not to be read as being consistent with the definition of 'annual total remuneration' as defined in the Annex II *Acronyms and Glossary of Terms* in respect of own workforce.

ID 1047 – Conditions for incorporation by reference and content index

Category

Cross-cutting

Question asked

Is it mandatory to make explicit reference to the specific Disclosure Requirement when incorporating by reference, or is referring to Disclosure Requirements in other parts of the annual report in the IRO-2 table sufficient?

ESRS Reference

ESRS 1 paragraphs 119 and 120; ESRS 2 paragraph 56 (content index requirement)

Key terms

Incorporation by reference; references to ESRS Disclosure Requirements in other parts of corporate reporting; content index

Background

ESRS 1 paragraphs 119 and 120 state:

‘119. Provided that the conditions in paragraph 120 are met, information prescribed by a Disclosure Requirement of an ESRS, including a specific datapoint prescribed by a Disclosure Requirement, may be incorporated in the sustainability statement by reference to:

(a) another section of the management report;

(b) the financial statements;

(c) the corporate governance statement (if not part of the management report);

(d) the remuneration report required by Directive 2007/36/EC of the European Parliament and of the Council (9);

(e) the universal registration document, as referred to in Article 9 of Regulation (EU) 2017/1129(10); and

(f) public disclosures under Regulation (EU) No 575/2013 of the European Parliament and of the Council (11) (Pillar 3 disclosures). If the undertaking incorporates by reference information from Pillar 3 disclosures, it shall ensure that the information matches the scope of consolidation used for the sustainability statement by complementing the incorporated information with additional elements as necessary.

120. The undertaking may incorporate information by reference to the documents, or part of the documents, listed in paragraph 119, provided that the disclosures incorporated by reference:

(a) constitute a separate element of information and **are clearly identified in the document concerned as addressing the relevant Disclosure Requirement**, or the relevant specific datapoint prescribed by a Disclosure Requirement;

(b) are published before or at the same time as the management;

(c) are in the same language as the sustainability statement;

(d) are subject to at least the same level of assurance as the sustainability statement; and

(e) meet the same technical digitalisation requirements as the sustainability statement.’

ESRS 1 paragraph 56 states: 'The undertaking shall include a list of the Disclosure Requirements complied with in preparing the sustainability statement, following the outcome of the materiality assessment (see ESRS 1 Chapter 3), including the page numbers and/or paragraphs where the related disclosures are located in the sustainability statement. This may be presented as a content index. The undertaking shall also include a table of all the datapoints that derive from other EU legislation as listed in Appendix B of this standard, indicating where they can be found in the sustainability statement and including those that the undertaking has assessed as not material, in which case the undertaking shall indicate "not material" in the table in accordance with ESRS 1 paragraph 35.'

Answer

Yes, it is mandatory to make an explicit reference in the sustainability statement to the specific Disclosure Requirement (and, when applicable, to the datapoint of a Disclosure Requirement) when incorporating by reference. At the same time, it is also necessary to clearly identify in the source document (i.e. the document that the sustainability statement refers to) the content that the undertaking intends to incorporate by reference, as the information that corresponds to the relevant ESRS Disclosure Requirement (or the relevant specific datapoint) prescribed by an ESRS Disclosure Requirement.

Incorporation by reference according to ESRS 1 paragraph 119 requires that all the conditions of ESRS 1 paragraph 120 be met. One of those conditions is that the disclosure incorporated by reference 'constitute[s] a separate element of information and [is] clearly identified in the document concerned as addressing the relevant Disclosure Requirement(s), or the relevant specific datapoint(s) prescribed by a Disclosure Requirement' (see ESRS 1 paragraph 120 (a)). A reference in the sustainability statement only – for example, as part of the 'content index' as required by ESRS 1 paragraph 56 – to the sections that are incorporated by reference is not sufficient to meet the ESRS 1 paragraph 120(a) requirement. A clear identification in the document incorporated by reference (for example, in another section of the management report or the financial statements) addressing the relevant Disclosure Requirement(s) or the datapoint(s) is also needed.

ID 1056 – MDR-Actions, resources allocated

Category

Cross-cutting

Question asked

What does 'resources allocated' refer to specifically in each ESRS? Does it require, at a minimum, the disclosure of which departments or specific teams are in charge and/or the total budget allocated for that specific topic?

ESRS Reference

ESRS 2 paragraphs 66, 69, and AR 23; ESRS E1 paragraphs 26, 28, 29 and AR 20 to 22; ESRS E2 paragraphs 16, 18, 19 and AR 14; ESRS E3 paragraphs 15, 17 to 19 and AR 21; ESRS E4 paragraphs 25, 27 and AR 18; ESRS E5 paragraphs 17 and 19; ESRS S1 paragraphs 37, 43 and AR 48; ESRS S2 paragraphs 31, 38 and AR 44; ESRS S3 paragraphs 31, 38 and AR 43; ESRS S4 paragraphs 30, 37 and AR 41

Key terms

MDR-A; resources allocated

Background

ESRS 2 paragraph 66 states: 'The undertaking shall apply the requirements for the content of disclosures in this provision when it describes the actions through which it manages each material sustainability matter, including action plans and **resources allocated** and/or planned.'

ESRS 2 paragraph 69 states: 'Where the implementation of an action plan requires significant operational expenditures (Opex) and/or capital expenditures (Capex), the undertaking shall:

(c) describe the type of current and future financial and other **resources allocated** to the action plan, including, if applicable, the relevant terms of sustainable finance instruments, such as green bonds, social bonds and green loans, the environmental or social objectives, and whether the ability to implement the actions or action plan depends on specific preconditions, e.g. granting of financial support or public policy and market developments;

(d) provide the amount of current financial resources and explain how they relate to the most relevant amounts presented in the financial statements; and

(e) provide the amount of future financial resources.'

ESRS 2 paragraph AR 23 states: 'Information on **resource allocation** may be presented in the form of a table and broken down between capital expenditure and operating expenditure, and across the relevant time horizons, and between resources applied in the current reporting year and the planned allocation of resources over specific time horizons.'

ESRS S1-S4 state (e.g. ESRS S1 paragraph AR 48): 'When disclosing the resources allocated to the management of material impacts, the undertaking may explain which internal functions are involved in managing the impacts and what types of action they take to address negative and advance positive impacts.'

Because ESRS E1-E5, S1-S4 have numerous other references to 'resources allocated' when requiring disclosures, they are not replicated in this background section (see ESRS reference section).

The Annex II *Acronyms and Glossary of Terms* defines 'marine resources' and 'natural resources'.

Answer

The amount of current and future financial resources shall be disclosed, where the implementation of an action plan requires significant operational expenditures (Opex) and/or capital expenditures (Capex). The 'departments or specific teams in charge', on the other hand, may be disclosed.

The ESRS 2 Minimum Disclosure Requirements (MDR) on actions and resources (ESRS 2 paragraphs 66 to 69) are to be applied together with the Disclosure Requirements, including the Application Requirements, provided in the relevant topical ESRS.

The term **'resources allocated'** is not specifically defined in ESRS. Based on ESRS 2 paragraph 69, 'resources allocated' relates to significant Opex and Capex in terms of 'financial and other resources'. Again, where 'other resources' is not defined, however, it can be assumed that human resources are one major element of 'other resources'.

The term '**total budget allocated'** is not used in ESRS. However, the amount of current and future financial resources shall be disclosed by the undertaking in accordance with ESRS 2 paragraph 69 (b) and (c) when the implementation of an action plan requires significant Opex and/or Capex.

The undertaking may disclose the internal functions involved in managing material impacts in accordance with ESRS S1-S4 (e.g. ESRS S1 paragraph AR 48); this might include the 'departments or specific teams in charge' when disclosing resources allocated to the management of material impacts. There is no equivalent voluntary Disclosure Requirement in ESRS E1 to E5.

To note: regarding Minimum Disclosure Requirements on policies (ESRS 2 paragraph 65), 'The undertaking shall disclose information about policies adopted to manage material sustainability matters. This information shall include:

(a) the **most senior level in the undertaking's organisation** that is accountable for the implementation of a policy …'.

ID 1057 – Targets – only qualitative?

Category

Cross-cutting

Question asked

Can targets also be qualitative if they are specific enough?

ESRS Reference

ESRS 1 paragraph 33; ESRS 2 paragraphs 80-81; definitions of 'target' and 'metrics' in Annex II *Acronyms and Glossary of Terms*

Key terms

Targets, only qualitative; targets; metrics

Background

The submitter provided the following background to the question asked: 'In all topical ESRS, it is required to disclose the targets that the company has set. While in certain cases targets must be quantitative (e.g. ESRS E1) in others this is not defined, so could a qualitative target still be compliant?

For example, regarding ESRS E4, could 'align in the next two years with EU Biodiversity 2030 Strategy' be considered a target? And in ESRS S2, could 'engage with value chain workers through annual surveys' be considered a target?'

Annex II *Acronyms and Glossary of Terms* defines **targets** as: 'Measurable, outcome-oriented and time-bound goals that the undertaking aims to achieve in relation to material impacts, risks or opportunities. They may be set voluntarily by the undertaking or derive from legal requirements on the undertaking.'

Annex II *Acronyms and Glossary of Terms* defines **metrics** as 'Qualitative and quantitative indicators that the undertaking uses to measure and report on the effectiveness of the delivery of its sustainability-related policies and against its targets over time. Metrics also support the measurement of the undertaking's results in respect of affected people, the environment and the undertaking.'

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

ESRS 2 paragraph 80 states: 'The undertaking shall disclose the measurable, outcome-oriented and time-bound targets on material sustainability matters it has set to assess progress. For each target, the disclosure shall include the following information:

(a) a description of the relationship of the target to the policy objectives;

(b) the defined target level to be achieved, including, where applicable, whether the target is absolute or relative and in which unit it is measured;

(c) the scope of the target, including the undertaking's activities and/or its upstream and/or downstream value chain where applicable and geographical boundaries;

(d) the baseline value and base year from which progress is measured;

(e) the period to which the target applies and, if applicable, any milestones or interim targets;

(f) the methodologies and significant assumptions used to define targets, including, where applicable, the selected scenario, data sources, alignment with national, EU or international policy goals and how the targets consider the wider context of sustainable development and/or local situation in which impacts take place;

(g) whether the undertaking's targets related to environmental matters are based on conclusive scientific evidence;

(h) whether and how stakeholders have been involved in target setting for each material sustainability;

(i) any changes in targets and corresponding metrics or underlying measurement methodologies, significant assumptions, limitations, sources and processes to collect data adopted within the defined time horizon. This includes an explanation of the rationale for those changes and their effect on comparability (see Disclosure Requirement BP-2 Disclosures in relation to specific circumstances of this Standard); and

(j) the performance against its disclosed targets, including information on how the target is monitored and reviewed and the metrics used, whether the progress is in line with what had been initially planned, and an analysis of trends or significant changes in the performance of the undertaking towards achieving the target.'

ESRS 2 paragraph 81 states: 'If the undertaking has not set any measurable outcome-oriented targets:

(a) it may disclose whether such targets will be set and the timeframe for setting them, or the reasons why the undertaking does not plan to set such targets;

(b) it shall disclose whether it nevertheless tracks the effectiveness of its policies and actions in relation to the material sustainability-related impact, risk and opportunity , and if so:

    (i) any processes through which it does so;

(ii) the defined level of ambition to be achieved and any qualitative or quantitative indicators it uses to evaluate progress, including the base period from which progress is measured.'

Answer

Yes, targets can be qualitative only if they are specific enough.

Targets as defined in ESRS (see Background) are 'measurable, outcome-oriented, time-bound goals that the undertaking aims to achieve in relation to material impacts, risks or opportunities.' Metrics are used to measure results against targets. As metrics per the metrics definition can be 'qualitative and quantitative indicators that the undertaking uses to measure and report on the effectiveness of the delivery of its sustainability-related policies and against its targets over time', targets can be quantitative or qualitative.

ESRS do not require undertakings to set targets on a quantitative basis only except when explicitly specified (see, e.g., ESRS E1 Disclosure Requirement E1-4).

If the undertaking sets qualitative targets, they shall be specific enough to meet the Disclosure Requirements of the Minimum Disclosure Requirements – Targets MDR-T – Tracking effectiveness of policies and actions through targets and of the datapoints in the respective topical or sector-specific ESRS. Reference is made to ESRS 2 paragraph 80.

As such, the example provided by the submitter (see background section) regarding the 'alignment in the next two years with EU Biodiversity 2030 Strategy' could - depending on the specific facts and circumstances - be a target in the context of ESRS E4. However, 'engaging with value chain workers through annual surveys in the context of ESRS S2' would not qualify as an outcome-oriented target and would not meet the MDR-T requirements referenced above.

If the qualitative target cannot be considered a measurable and outcome-oriented target, disclosures under ESRS 2 paragraph 81 and not under paragraph 80 are applicable (see also ESRS 1 paragraph 33).

ID 1090 – Length of transitional provisions for early adopters

Category

Cross-cutting

Question asked

Which year does the phase-in apply for a company that voluntarily publishes a CSRD-report one year prior to being required? What about comparative information?

ESRS Reference

ESRS 1 paragraph 136 and 137; ESRS 1 Appendix C: *List of phased-in Disclosure Requirements*

Key terms

Phase-in requirements; comparative information; early adopters

Background

ESRS 1 paragraph 136 states: 'To ease the first-time application of this Standard, the undertaking is not required to disclose the comparative information required by section 7.1 *Presenting* *comparative information* ***in the first year of preparation*** *of the sustainability statement under the ESRS.*'

ESRS 1 paragraph 137 states: 'Appendix C: *List of phased-in Disclosure Requirements* in this Standard sets phase-in provisions for the Disclosure Requirements or datapoints of Disclosure Requirements in ESRS that may be omitted or that are not applicable in the **first year(s) of preparation** of the sustainability statement under the ESRS.'

Answer

The voluntarily publication of sustainability statements one year earlier than required under CSRD does not affect the phase-in requirement periods granted by ESRS 1.

Voluntary early application of the ESRS sustainability statement by an undertaking does not count in respect of the years of preparation under ESRS, is not recognised legally, and therefore does not affect the date from when the phase-ins should be calculated. Accordingly, in the year of mandatory application of ESRS, the undertaking may present its sustainability statement without comparative information in accordance with ESRS 1 paragraph 136 even if it has prepared a voluntary sustainability statement in the preceding year.

Environment

ID 815 – Substances of concern – in articles

Category

Environment

Question asked

The current EU legislation requires to monitor substances of concern in chemicals but not in articles. If no (or only partial) information (including due to suppliers' lack of responsiveness) is available on substances of concern contained in the manufactured articles, what should the company disclose?

ESRS Reference

Disclosure Requirement E2-5 paragraph 34

Disclosure Requirement E2-5 paragraph AR 28

Key terms

Substances of concern; SoC; procurement; articles

Background

E2 paragraph 15 states: 'The undertaking shall indicate, with regard to its own operations and its upstream and downstream value chain, whether and how its policies address the following areas where material …

(b) substituting and minimising the use of substances of concern; and …'.

ESRS E2 paragraph AR 13 states: 'Where actions extend to upstream or downstream value chain engagements, the undertaking shall provide information on the types of actions reflecting these engagements.'

ESRS E2 paragraph AR 19 states: 'The targets may cover the undertaking's own operations and/or the value chain.'

ESRS E2 paragraph 34 states: 'The disclosure required by paragraph 32 shall include the total amounts of substances of concern that are generated or used during the production or that are procured, and the total amounts of substances of concern that leave its facilities as emissions, as products, or as part of products or services split into main hazard classes of substances of concern.'

ESRS E2 paragraph 34 states: 'The undertaking shall present separately the information for substances of very high concern.'

ESRS E2 paragraph AR 28 states: 'In order for the information to be complete, substances in the undertaking's own operations and those procured shall be included (e.g. embedded in ingredients, semi-finished products, or the final product).'

ESRS 1 paragraph 71 states: 'With reference to policies, actions and targets, the undertaking's reporting shall include upstream and/or downstream value chain information to the extent that those policies, actions and targets involve actors in the value chain. With reference to metrics, in many cases, in particular for environmental matters for which proxies are available, the undertaking may be able to comply with the reporting requirements without collecting data from the actors in its upstream and downstream value chain, especially from SMEs, for example, when calculating the undertaking's GHG Scope 3 emissions'.

ESRS 1 paragraph 34 states: 'When disclosing information on metrics for a material sustainability matter according to the Metrics and Targets section of the relevant topical ESRS, the undertaking: …

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

Regulation (EC) No 1907/2006 (REACH), Article 3 defines 'article' as 'an object which during production is given a special shape, surface or design which determines its function to a greater degree than does its chemical composition'. Regulation (EC) No 1907/2006 (REACH), Article 33 on the 'Duty to communicate information on substances in articles' states: '1. Any supplier of an article containing a substance meeting the criteria in Article 57 and identified in accordance with Article 59(1) in a concentration above 0,1 % weight by weight (w/w) shall provide the recipient of the article with sufficient information, available to the supplier, to allow safe use of the article including, as a minimum, the name of that substance. 2. On request by a consumer, any supplier of an article containing a substance meeting the criteria in Article 57 and identified in accordance with Article 59(1) in a concentration above 0,1 % weight by weight (w/w) shall provide the consumer with sufficient information, available to the supplier, to allow safe use of the article including, as a minimum, the name of that substance'.

Answer

If substances of concern (and/or substances of very high concern) in articles represent a material topic for the undertaking:

(a) for the **metrics** disclosure of ESRS E2 paragraphs 34 and 35, the undertaking shall consider both those within its production processes as well as the ones entering its own operations through procurement as an ingredient, semi-finished products, or final products. If the metric cannot be determined through direct data collection, e.g. by obtaining it from suppliers, after making a reasonable effort to do so, it shall be estimated by using proxies. Reference is made to 'ID 504 – *Disclosure Requirements on material metrics when information is not available*; and

(b) the undertaking shall, in any case, report on the related **policies, actions and targets** (PAT) it has in place in relation to the material topic. ESRS E2 provides in particular specific indications on the extension of the reporting under the PAT to the value chain. Concerning policies, the undertaking must disclose whether and how its policies support the substitution and minimisation of the use of substances of concern. This information is to be provided also for its upstream and downstream value chain. With regard to actions, undertakings shall report on upstream and downstream value chain engagements when present. The extension of targets to value chain entities is, however, optional.

Concerning the specific case of substances of very high concern (SVHC) in articles, Regulation (EC) No 1907/2006 (REACH) requires communicating SVHC content where specific thresholds are exceeded.

To note: Information to be collected from value chain entities can be omitted during a three-year phase-in period in accordance with ESRS 1 Chapter 10.2 *Transitional provision related to Chapter 5 Value chain*, unless it is prescribed under EU legislation.

Reference is made to [Draft] Question 29 *ESRS require undertakings to use estimates if they cannot obtain all necessary value chain information after having made reasonable efforts to do so (ESRS 1 General requirements paragraph 69). What constitutes 'reasonable effort'?* from the European Commission on the interpretation of certain legal provisions in Directive 2013/34/EU (Accounting Directive).

Supporting material

Regulation (EC) No 1907/2006 of the European Parliament and of the Council of 18 December 2006 concerning the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH).

Social

ID 573 - Persons with disabilities – definition

Category

Social

Question asked

Disability is the umbrella term for impairments, activity limitations and participation restrictions, referring to the negative aspects of the interaction between an individual (with a health condition) and that individual's contextual factors (environmental and personal factors). Given this definition, could it then be interpreted that one must not report on persons with disabilities if they e.g., have a desk job and their physical difficulties do not impact their work?

ESRS Reference

ESRS S1 paragraph 79, ESRS S1 paragraph AR 76

Key terms

Persons with disabilities

Background

The glossary defines ‘Persons with disabilities’ as: ‘Persons who have long-term physical, mental, intellectual or sensory impairments which in interaction with various barriers may hinder their full and effective participation in society on an equal basis with others.’ The definition provided by the submitter in the question is derived from the Draft ESRS S1 (which is also based on the UNCRPD).

ESRS S1 paragraph 79 states: ‘The undertaking shall disclose the percentage of persons with disabilities amongst its employees subject to legal restrictions on the collection of data.’

ESRS S1 paragraph AR 76 states: ‘When disclosing the information required in paragraph 77 regarding persons with disabilities, the undertaking shall provide any contextual information necessary to understand the data and how the data has been compiled (methodology). For example, information about the impact of different legal definitions of persons with disabilities in the different countries in which the undertaking has operations.’

Answer

No, the undertaking shall disclose the percentage of its own employees with disabilities as defined in Annex II Acronyms and Glossary of terms. The undertaking is not expected to assess whether or how an employee's disability might interfere with the particularities of the employee's tasks for the purpose of this datapoint.

While the definition included in the glossary is derived from the UN Convention on the Rights of Persons with Disabilities (UNCRPD), it is not intended as criteria for employers to assess individual employees. Disability status depends on national legal definitions of persons with disabilities and the specific assessments of disabilities vary between countries. The definitions and data collections provisions are regulated at national level. Undertakings are required to provide contextual information per ESRS S1 paragraph AR 76, that is necessary to understand how the data has been compiled, as the legal definitions of persons with disabilities differ between countries. Data collection for this information is subject to legal restrictions and reporting on persons with disabilities relies on the self-identification and self-declaration of the undertaking’s employees.

Supporting material

The preamble of the UNCRPD recognises disability as ‘an evolving concept’ that ‘results from the interaction between persons with impairments and attitudinal and environmental barriers that hinders their full and effective participation in society on an equal basis with others.’

Article 1 UNCPRD defines ‘persons with disabilities’ as ‘those who have long-term physical, mental, intellectual or sensory impairments which in interaction with various barriers may hinder their full and effective participation in society on an equal basis with others.’ The UNCRPD definition of ‘persons with disabilities’ is intentionally broad to highlight the possible barriers persons with disabilities face that hinder their full and effective participation in society.