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

Table of content

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*.'

An **SRB member** suggested the following alternative Re 'Own operations':

Own operations is not a defined term 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, ***however, other factors depending on the specifics of the business model, which may have an influence on operational control, may in- or decrease the scope/boundaries of own operations****. Sector standards* ***or sector specific guidance*** *may define specific provisions to define own operations and upstream and downstream value chain considering the peculiarity of transactions in that sector.*

The EFRAG Secretariat thinks that the proposed rewording is too generic and open to unintended deviations from the general principles without a clear underlying rationale (i.e. may increase or decrease). We propose instead the following alternative:

'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). <u>In specific circumstances there may be a deviation from this general approach. For example, in the banking sector prevailing practices when reporting GHG emissions, classify Scope 3 emissions connected with the loan portfolio as part of the value chain (Scope 3), despite loans being on balance sheet.</u> 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.'*

Question for the SRB: Do you agree to amend the 'own operations' section as suggested above by the EFRAG Secretariat?

Answer

<u>Own operations</u>

'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).