

Feedback on EFRAG's (Draft) IG 2: VCIG

Do you have any comment on any of the following:

| | Yes, I will provide my comments bellow | No comments |
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Summary in 7 key points

- Par 2: Substance – major change Par 2. should acknowledge that the value chain coverage is not required in all disclosures.

"The undertaking is not required to include value chain (VC) information in all disclosures, but in certain cases when it is connected with material IROs beyond its own operations, due to its business relationships and when it is specifically required by the disclosure requirement."

For instance, even if energy is material in the value chain, the energy consumption data shall only be reported on own operations (considering energy is also material for own operations). The energy issue in the value chain shall also be listed as a material matter, but no precise metrics is required. Reporting is on the VC but VC information is not required each time an information is connected with material IROs.

- Par 4: Substance – major change Par 4. should explicitly state that the value chain coverage is not mandatory, as the scope of PAT is determined by the undertaking. The scope of the policy is required but remains the responsibility of the undertaking.

"When describing the PATs for material matters, the disclosure shall include information about whether, and if so, how this address material upstream and/or downstream VC IROs." // OR "When describing the PATs for material matters, the disclosure shall include information about how this address material upstream and/or downstream VC IROs to the extent that those PATs involve actors in the value chain."

- Par 6: Substance – major change The wording should be changed as the first intent of ESRS is not to collect primary VC information for the identification of the material IROs.

Furthermore, while value chain coverage is crucial for the materiality assessment, it is **not required for metrics**, except in specific cases outlined in the IG (e.g., GHG emissions)

~~"When the undertaking cannot collect primary VC information for the materiality assessment or in order to prepare its disclosures of material IROs after making reasonable efforts. Primary VC information on specific ESG "hotspots" can be obtained through due diligence processes (such as suppliers audits) but systematic collection of primary VC information all along the value chain in particular outside Europe and from tier >1 suppliers is simply not feasible. Tthe undertaking shall estimate the missing information [...]"~~

As stated in Par 28, "ESRS does not require information on each and every actor in the VC".

- Par 7: [Substance Minor change]: Par 7 should also refer to ESRS E2 and E4, as the concept of operational control is clearly mentioned in these ESRS as well (e.g., pollutant quantities and site associated with material biodiversity matters).

"Also refer to chapter 2.3 below on operational control which is relevant for ESRS E1 Climate change, ESRS E2 Pollution and ESRS E4 Biodiversity."

- Par 7: wording: *The inclusion of VC information is the extent to which the sustainability statement covers the relationships that all the undertakings entities in the consolidation perimeter have with their respective VC counterparts, including beyond the first tier.*

Chapter 1: Introduction

No comment

Chapter 2: Navigating value chain under CSRD and ESRS

- [Format] In par 18., par 23., and par 26., the link to Annex 2 of the July 2023 delegated act is not working.

Detailed requirements

- [Substance – Minor change] **Par 21 (b)**. should explicitly remind that PAT adoption is at the discretion of the undertaking, given that CSRD is designed for transparency requirements and not behavioral prescription.

"All the topical standards require undertakings to disclose their policies, actions and targets for material IROs when the undertaking has adopted such PATs; to the extent that such policies, actions and targets address material IROs in the VC, this will be reflected in the disclosures."

- [Substance – Minor change] **Par 21 (c)**. needs clarification to explicitly outline which metrics require value chain information, preventing potential contradictions with other sections. For example, the absence of metrics in ESRS S2 to S4 is not linked to the value chain coverage of metrics.

“There are only few sector-agnostic metrics in topical ESRS that require VC information (see FAQ 6 Should VC information be included in metric DRs?). For specific quantitative and qualitative data points requiring VC coverage, refer to rows 8 to 9 of the VC coverage map. Furthermore, disclosures pertaining to produced materials are indicated in row 7. ~~ESRS S2 to S4 for instance do not include metrics per se.~~ The other metrics do not refer to the value chain. ~~However, this includes some information about procured materials, please refer to rows 6 to 8 of the VC coverage map of Set 1 ESRS.~~”

[Substance – Minor change] Par 21 (d)

*“Finally, when an undertaking concludes that a material IRO is not sufficiently covered by an ESRS, it shall provide **entity specific** additional disclosures to enable users to understand its IROs. (ESRS 1 paragraph 11 and AR 1 to 5). This may include information, including when appropriate metrics, about a material IRO in the VC”*

2.1 What is the VC?

- **[Wording – Minor change]**: “Should IROs linked to all **each and every** actors in the VC be considered?”
- **[Substance – Minor change]** In **par 29.**, it could be considered including a reference to FAQ 9 for consistency.

“Leverage may affect the ability of the company to obtain data from its counterparties in the VC. This may be relevant for the reporting of material impacts as well as for reporting metrics including entity-specific information (See ESRS 1 AR 1 to AR 5) and may lead the undertaking to use estimates and proxies (see below “FAQ 9: How can estimates be developed when primary data cannot be collected from VC counterparties?).”

- **[Wording – Minor change]**: In **par 31**
*“Leverage may affect the ability of the company to obtain ~~data~~ **information** from its counterparties in the VC.”*

2.2 Why does VC matter?

- **[Substance – Minor change] Par 32.** should explicitly state that only material information about the value chain is required.

*“CSRD and ESRS require that the sustainability statement include **material** information about the upstream and downstream VC.”*

- **[Substance – Minor change] Par 33:** Delete « major ». It is false to state that major IROs relate to VC

“The reason for this is that the ~~major impacts, or major risks~~ and opportunities deriving from impacts or dependencies, of a reporting undertaking often occur in its upstream or downstream VC rather than in its own operations.”

- **[Substance – Minor change] Par 33, b.** It should be clearly stated that the “factory outside the EU” is a supplier in the VC.

“Another example is a European retailer with wooden toys made in a supplier’s factory outside the EU, where legal requirements are less stringent.”

- [Substance – Minor change] Par 33, c. No need for "or most".

“Similarly, Scope 3 GHG emissions are expected to be material for many ~~or most~~ undertakings”.

2.3 From own operations to value chain

The reporting group as starting point

- [Substance – major change] The paragraphs 34 to 39. should more distinctly outline the two successive steps in defining the reporting scope of the undertaking – namely, 1. financial control and 2. operational control analysis (mainly applied for E1). The starting point is the financial scope of reporting, encompassing both the parent company and subsidiaries. This means that if the undertaking holds financial control over an entity, a separate operational control analysis is unnecessary, as it is inherently part of the reporting scope. For instance, there is no case where a subsidiary could be excluded because the undertaking has financial control but no operational control. The flowchart in paragraph 53 illustrates well that only additions to the scope of financial control are possible in relation to operational control, with no deletions. But further clarifications in paragraphs 34 to 39 would be beneficial.
- [Substance – minor change] par 36 Reference to Chapter 5.2 FAQs does not provide a clear answer to the question. We should add a sentence explaining that a subsidiary excluded from the financial reporting consolidation on the basis of financial materiality for practical reasons should however be assessed for sustainability materiality as materiality definition under ESRS is different from materiality applied for financial statements.
- [Substance – major change] Par 38 Associates and joint ventures, when **solely business relationships and not actors in the VC**, should be considered as potential sources of material IROs. No additional requirements apply beyond the materiality assessment (cf. §50 of the IG).
- [Substance – minor change] Par 39 refers to operational control in relation to a site, an asset or an entity outside the financial control perimeter. However, par 53 mentions operational control in relation to sites, assets, plants, 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). This minor discrepancy could lead to confusion and should be addressed for consistency.

Operational control – E standards

- **[Substance – major change]** In par 40 to 42, it is imperative to clarify the definition of operational control, providing more precise guidelines for a comprehensive understanding. Alongside a thorough, contract-specific analysis, additional discerning directions would prove beneficial.

In the introduction of the box “Operational control (over an asset, a site, or a plant, JVs, Associates, etc.)”, it should explicitly state that operational control, **as referred to in the GHG Protocol**, pertains to **technical** operational control – signifying the ability to direct operations generating GHG emissions, not solely the ability to direct the financial operations of the entity generating GHG emissions, in relation to ESRS E1.

Operational control should be explained to apply outside situations of financial control within the framework of a **contractual relationship** (e.g., concession, service or franchise agreements, etc.) to manage entities, sites, operations or assets or activities. Therefore, the applicability of operational control may vary by **sector**. Examples of contractual relationships to be considered should be given, especially for high impact sectors – such as the recourse to leases or concession or production-sharing agreements or contracts for the oil and gas sector.

For instance, it should be specified that under a build & operate contract, both the owner and the operator of the asset have to disclose the GHG emissions.

- **[Substance – minor change]** Par 40 to 43. could provide further clarity on how to define the reporting scope of GHG emissions, by reminding the successive steps of the scope analysis (1. financial reporting scope, 2. operational control) and by mentioning the unique considerations for financial undertakings.

“The undertaking should define the reporting scope of GHG emissions first based on the reporting scope of the financial statements. This means that the undertaking should include the parent company and financially-controlled subsidiaries, whose GHG emissions should be 100% consolidated.

In the case of GHG emissions, this scope should be extended to entities over which the undertaking has operational control. This control generally depends on contractual relationships. All the GHG emissions (scopes 1, 2 and 3) of these entities should be reported at 100%, a priori in the undertaking’s scopes 1 and 2. In the rare cases where the contractual agreement is explicit on this subject, ESRS E1 requires reporting in proportion to operational control, for example, in the case of part-time use of emitting assets.

It should be noted that financial undertakings generally do not have operational control over the GHG emissions financed or insured, as this is not their core business. Calculation rules for these financial undertakings will be specified in sector-specific standards.”

- **[Substance – minor change]** Par 40 to 43. Additional paragraphs could be added here or in the FAQ to clarify how to classify GHG emissions into scopes 1, 2 and 3, particularly if EFRAG does not intend to develop IG on E1.

- *“The question of classifying emissions into scopes 1, 2 and 3 is distinct from that of the scope, and should be dealt with after the scope has been defined. ESRS E1*

(paragraph 50) calls for scopes 1 and 2 emissions to be separated according to whether they come from controlled operations (reporting scope) or from the rest of the value chain when there is operational control (extension). Scope 3 emissions from entities in the rest of the value chain must be estimated and reported in accordance with the GHG Protocol when the emission categories are significant. The initial criterion for identifying significant Scope 3 categories is the magnitude of estimated emissions (i.e., contribution to total Scope 3 emissions). Other criteria may also be taken into account, such as the relationship between accessibility (i.e., availability of data needed to quantify emissions) and reliability (i.e., quality and accuracy of available data), as well as the ability to influence (i.e., potential emission reductions that could be driven or influenced by the company). The 15 categories of scope 3 do not have to be calculated, but transparency and consistency of methods are required."

- Additionally, in the case of joint ventures with a combination of financial and operational control, the methodology for calculating their turnover in the reporting of the GHG emissions intensity ratio should be clarified.
- Further details on reporting guidelines for actors in the value chain:
 - When there is an actor in the value chain where the reporting undertaking has operational control, GHG emissions should be reported in Scope 1 or 2.
 - When there is an actor in the value chain where the reporting undertaking does not have operational control, GHG emissions should be reported in Scope 3 – for instance in category 1 or 11 based on the units of products and/or services purchased or sold; and if no products and/or services are bought or sold using the equity method, in category 15, proportionate to the share of emissions from the equity method.
- **[Substance – minor change] Par 45.** introduces the concept of operational control to other ESRS. While acknowledging the relevance of mentioning this principle, it should be clarified that that it falls within the realm of interpretation and not explanation, as ESRS 1 does not uniformly mandates its application across all ESRS. Alternatively, a more explicit justification could be provided, aligning with the general consistency provision of QC19 in ESRS 1.

Operational control – S standards

- **[Substance – minor change] Par 47.** should clarify that the definitions in social ESRS take precedence to the concept of operational control when assessing the reporting scope. They should also explain the application of the operational control to ESRS S1 and S2 by providing examples. Finally, it could be stated that operational control should be captured through entity-specific disclosures in social ESRS for now. As currently drafted, Par 47 may bring confusion.

Associates and joint arrangements

- **[Substance – minor change] Par 48 to 49** should clarify that, in general, ~~all~~ material IROs ~~should~~ could be reported for joint ventures ~~and associates~~, even in cases where there are

only business relationships characterised by a capital-intensive holding and not directly linked to the business model of the undertaking.

This is particularly relevant for financial undertakings whose primary function is investment. It could be mentioned that the scope rules for financial undertakings should be specified in the sector standards. Their material IROs will necessarily be identified for all their investments, regardless of their percentage holding, in line with SFDR provisions.

However, **this is less relevant for Corporates. Therefore**, we would recommend providing additional examples of situations where an associate or a joint venture do or do not form part of the VC. In **particular**, the following exception could be introduced for corporates: any **joint ventures and associates** acquired through acquisitions, but not intended to be retained as financial assets due to misalignment with the overall strategy **and activities**, may be excluded from the IRO materiality analysis.

Reporting boundary decision tree

- **[Substance – minor change]** **Par 53** - The graph (decision tree) is not very convincing nor nice in terms of form and colours. At least we could improve the form. We should precise that par.53 applies to metrics and not to IRO identification (MA).

2.5 How do the transitional requirements work?

- **[Substance – major change]** **In par 57.**, the reference to “data gathering aspects” covers qualitative and quantitative information. However, quantitative metrics in the ESRS are not requested on the value chain, except for few cases where no direct quantitative data collection is needed (use of proxies and sector average). Therefore, the following paragraphs of this section should focus on the qualitative information.
- **[Substance – minor change]** **par 58**, this transitional provision is somehow misleading as metrics (quantitative information) are not required on the VC but rather on the own operations. IRO assessment will be built on information that is not directly collected with VC actors. At the end, this provision is not providing any real relief but from a perception point of view, it is not bad to have it!
- **[Substance – minor change]** **In par 60.** No VC information is needed. See previous comment. We add complexity without adding value. A nuanced perspective could be considered by acknowledging that this situation may persist beyond three years. Understanding and acquiring knowledge about the value chain is an ongoing, continuous exercise, with the emphasis on continual improvement of this knowledge.

Par 60, (c): *“its plan to obtain the necessary information in the future”*. What kind of new information will be necessary in the future?

- **[Substance – minor change]** **In par 62.**, it is suggested to revise the wording to: “except for **a limited number of** datapoints derived from other EU legislation”, as very few metrics from EU Datapoint cover the entire value chain. Additionally, it should be noted that these

metrics do not necessitate direct quantitative data collection but are often based on proxies and sector averages.

- **[Substance – minor change] Par 63.** should be redrafted as follows: “starting from its fourth year of reporting under ESRS, the undertaking shall include VC information according to ESRS 1 paragraph 63 (ESRS 1 paragraph 135), **which mainly corresponds to qualitative information on the value chain, and** as explained in this document.

Chapter 3: FAQ 1: Where does the VC begin and end?

No comment

Chapter 3: FAQ 2: Are financial assets (loans, equity and debt investments) considered business relationships that trigger VC information?

- **[Substance – major change]** FAQ 2 **Par 77.** We should clarify whether investees’ metrics should be consolidated at investment fund level when the fund holds the majority of the voting rights.

Chapter 3: FAQ 3: How should the MA process be organised to properly capture material IROs in the VC?

Step A. Understand the context

- **[Wording – minor change] Par 85**

*“The strategy of the undertaking will influence its business model which will focus on its own operations but also include aspects around its up- and downstream value chain. All of this will be considered **in** its materiality assessment.”*

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

- **[Substance – major change] Par 89**

How does EFRAG reconcile this sentence with §79 " MA includes information related to the VC, but not information on each and every actor in the VC". EFRAG should add "Where applicable" or "For potentially material IROs in the VC, the undertaking should aim...".

*“**Where applicable the** undertaking should aim to gather reliable data from actors in its VC.”*

- **[Wording – minor change] Par 90** – Is the verb missing? Or whether should be deleted.

The undertaking is required to provide a description of whether the material impacts, risks and opportunities connected to the undertaking as well as those that are directly linked to its operations and services in its upstream or downstream value chain (ESRS 2 SBM-3 paragraph 48 (a)).

Chapter 3 FAQ 4: How should information about the VC be disclosed in the context of the materiality assessment

BP1 – General basis for preparation of the sustainability statement

- [Wording – minor change] Par 96

ESRS 2 paragraph 5(c) requires disclosing to which ~~the~~ extent the sustainability statement covers the undertaking's upstream and downstream VC. Therefore, in addition to metrics, this applies to all the steps below, to the extent that material IROs arise in the upstream and downstream VC.

Chapter 3 FAQ 5: Should VC information be included for Policies, Actions or Targets (PATs) Disclosure Requirements?

- [Substance – minor change] par 108 The first sentence of paragraph 108 is ambiguous. Paragraphs 64 (b), 67 (b), and 70 (b) of ESRS 2 require the description of the scope of the policy. However, this does not imply that the policy, actions, and targets should necessarily encompass the entire value chain.
- [Wording – minor change] par 114
"Yes, for material IROs (including those in the VC), where the undertaking has PATs, it should disclose ~~this~~ *whether and how the policy covers the value chain*" (ESRS 2 paragraphs 64(b), 67(b) and 70(b))."
- [Wording – minor change] par 116
"As a reminder, the undertaking can comply by disclosing that it has not adopted policies and/or actions with reference to the relevant sustainability matter and provide reasons for this *or that its policies only cover its own operations*"

Chapter 3 FAQ 6: Should VC information be included for Metrics Disclosure Requirements?

- [Substance – major change] Par 122. should be removed, as it goes beyond what is written in the ESRS – and may even contradict provisions in ESRS 1 – by mandating VC information metrics or VC data in the metrics according to the result of the materiality analysis. For instance, par 122. (a) provides an example of metric that is not listed in the ESRS.

Par 122, a) *"Impact data of suppliers should be included in the reported metrics"*

No. This sentence do not reflect ESRS requirements. Please delete or smoothen the "should be included". Impact information of suppliers should be identified as an IRO but metrics are not necessarily required at entity-specific level. It is the responsibility of the undertaking to decide and usually quantification of the suppliers' impacts is not feasible.

Par 122, b) *"the percentage of workers in value chains in high-risk areas being covered by social security schemes"* The estimated calculation of workers in the value chain is already a best

practice. Disclosing the % covered by social security scheme will be an approximation of an approximation.

- **[Wording – minor change]** In **par 124.**, instead of being affirmative about future standardization, it could be more accurate to use "may" to indicate the potential coverage.

Chapter 3 FAQ 7: How to assess and quantify the impacts of the VC resulting from business relationships?

- **[Substance- Major change]** **Preliminary remark:** The intent of ESRS is not to collect information from each and every actor in the VC. The drafting of this FAQ is to be reconsidered. At least, EFRAG should talk about direct business relationships. There is no way to quantify the impacts from other actors except through audits.
- **[Substance – major comment]** **Par 126:** What VC data required by metrics are we referring to? This part of the sentence should be deleted.
"For the materiality assessment and for the inclusion of VC data required by metrics, the undertaking may either obtain information directly from actors in its VC or use estimates or proxies or combine both approaches."
- **[Substance – minor comment]** **Par 128:** *"It should be noted that the more severe the impact is, there may be a strong incentive to omit such sensitive information, and this could impact the reliability of the information provided by such supplier. This may be particularly relevant for incidents of child or forced labour in the VC"*. This paragraph is really naive. Obviously, suppliers will not explain to their customers that they offer low price products because they are produced by children ! This paragraph can be deleted to protect the VCIG credibility.
- **[Substance – minor change]** **Par 129:** The recommendation in par 129. is unrelated to this guidance on ESRS and should be removed. There is a need to clarify that we are talking about Tier 1 suppliers and not actors in the VC.
"Apart from this issue, the reliability of information directly obtained from the VC may improve over time since VC actors may not be able to quantify their impacts yet but may be in a position to do so in the future given evolution of sustainability reporting".
- **[Substance – major comment]** **par 130:** The example in the second sentence of par 130. insinuates that all significant suppliers should be queried, which is not required under ESRS. It should be considered redrafting or deleting the sentence.
- **[Substance – major comment]** **par 131:** This is not the purpose of the ESRS to collect quantitative data in the VC. This sentence should be redrafted or deleted
"The undertaking shall estimate the impact when it cannot collect the necessary data to the required reliability after reasonable effort."
- **[Substance – major comment]** **par 132-** EFRAG is reinventing LCA without naming it. At least, mention LCA as the relevant source for impacts from use of sold product.
"In this case, estimating its impact would involve considering variables such as volumes sold, average time the inventory will be cooled before consumption and an estimate of the average electricity used to cool its products on a unit basis. This may need to also

consider location and related prices. Depending on its assessment of the materiality of electricity use, the undertaking may want to provide a sensitivity analysis of its electricity use depending on reasonably possible changes in the important variables in its calculation. Proxies are often available at sector or product level ».

- [Substance – minor change] In relation to par 133., the priority purpose of par 10. of ESRS 2 is to address the metrics on own operations, not on the value chain. This distinction should be introduced.

Chapter 3 FAQ 8: What is 'reasonable effort' to collect VC data?

- [Wording – minor change] Par 134: Replace "collects" by "gathers" as there is no systematic data collection in the VC.
"When inclusion of VC information is necessary, under ESRS 1 paragraph 63 or on entity-specific basis, a reporting entity ~~collects~~ gathers information about its upstream and downstream VC only to the extent that this is compatible with a reasonable effort (ESRS 1 paragraph 69) for use in its sustainability statement".

Chapter 3 FAQ 9: How can estimates can be developed when primary data cannot be collected from VC counterparties?

- [Substance – major comment]: The collection of primary data in VC is NOT the purpose of the ESRS; The title of the FAQ 9 should be redrafted
- [Substance – major comment] par 143: This sentence should be redrafted or deleted since the collection of primary data in VC is NOT the purpose of the ESRS.
"When collecting the necessary information from counterparties in the VC is not possible after reasonable efforts".
- [Substance – minor change] – Box Examples of external data sources.
Please add the ILO source for social protection by country: <https://wspdb.social-protection.org/> World social protection data dashboard (free)
- Substance – minor change] par 149 – Similar paragraph could be developed around social protection database
*"As set out in AR 73 of ESRS S1 Own workforce, the **WageIndicator** is indicated as a potential source (with others) for calculating adequate wage benchmarks outside of the EEA as the last option in the hierarchy."*
- [Substance – major comment] par 150: This sentence should be redrafted or deleted because collecting primary data in VC is NOT the purpose of the ESRS.
"Undertakings need to be aware that setting up a reliable data collection system which includes VC partners takes time. They may consider processes and controls to collect data and report the information."

Chapter 4 – VC Map VC coverage map of Set 1 ESRS

- [Substance – minor change] It should be specified that SFDR indicators listed in ESRS 2 Appendix B do not require generally figures from value chain actors.

- [Substance – major change] Other EU laws in appendix B are not requiring VC to be covered. The last lines of the table seem not to be relevant.
- [Substance – major change] – **par 154**: It is not a matter of reporting but a matter of coverage by PAT or S2,3 and 4. The title of the table is VC **Coverage** map not **Reporting** VC information. This map is welcome but should not imply that there is an expectation of necessary data collection in the VC.
"The table below maps the disclosure requirements in the sector-agnostic ESRS and whether reporting undertakings have to ~~report~~ cover VC information."