ACCOUNTANCY EUROPE'S CONTRIBUTION TO EFRAG'S DRAFT IG2: VALUE CHAIN IMPLEMENTATION GUIDANCE

(1) Accountancy Europe is pleased to contribute to EFRAG's draft IG2: Value Chain Implementation Guidance (VC IG). We welcome this draft VC IG as it provides guidance on a key concept in the European Sustainability Reporting Standards (ESRS). Indeed, we have been calling for this guidance on the previous ESRS consultations too.

(2) We acknowledge that guidance issued by EFRAG is limited to providing clarifications and illustrations to the ESRS as it will be a non-authoritative guidance. Interpretations are outside of EFRAG's mandate and fall instead under the European Commission's (EC) remit. This caveat informs our comments as summarised below.

GENERAL COMMENTS

(3) We welcome the clarifications on value chain topics in the VC IG, such as:

a. the different requirements to provide value chain information, such as for impacts, risks and opportunities (IRO), policies, actions and targets (PAT), and metrics

b. the difference between the requirement to consider value chain in the materiality assessment and the need to collect value chain data

c. using estimates from indirect sources when primary data cannot be collected

d. "reasonable" effort in collecting primary value chain data

e. the value chain map, which clarifies on what is needed to be reported.

(4) Nonetheless, we call for clearer implementation support that aims to support especially first-time reporters of sustainability information. This could have included:

a. more illustrative examples on all topics included in the guidance, particularly ones that would illustrate practical solutions on "operational control" over another entity or site

b. tools, methodologies or resources that help collect primary data

c. a list of potential sources to use to estimate indirect data

d. applicability criteria on indirect sources.

(5) We also believe that this guidance only considers entities operating in one sector. We invite EFRAG to consider how the value chain and its related concepts would apply in the cases of entities operating in more than one sector, including conglomerates.

(6) On another note, we invite EFRAG to also consider the impacts of the guidance in the assurance process and the quality of the evidence. For example, there will be cases where an entity's suppliers would be using old databases for their emissions and would not have updated them as per the newest

public information. For these cases and in general, it is important to consider what would constitute an acceptable level of data quality.

(7) In the paragraphs below we have included some additional targeted comments.

VALUE CHAIN BOUNDARIES

(8) We understand from the value chain definition that it includes activities, resources and relationships of the entity and the external environment it operates in. We also appreciate EFRAG's attempt to clarify this difficult matter in various paragraphs of the VC IG, including FAQ1.

(9) However, we strongly suggest EFRAG provides more guidance, including the factors to consider, and examples that further clarify where the value chain starts and ends, including for the purposes of the materiality assessment. It is important to understand whether the value chain ends where the entity:

a. does not have the ability to influence the actor in the value chain, or

b. has no significant business relationship, or

c. the contributions to the added value become minimal, or

d. other considerations.

(10) In addition, more guidance and examples will help ease ESRS-related burdens such as for reporting and for making judgements, estimates and assessments. In practice there are cases of companies going as far as tier 7 in the upstream value chain, but this may not be feasible for other preparers. The downstream value chain poses equally difficult feasibility challenges that examples, and guidance could help alleviate.

(11) We encourage EFRAG to also include more practical examples with cases not considered as value chain. For example, EFRAG could consider the example of a joint venture where a non-financial undertaking has joint control over it, that would not be considered as an actor in the value chain, but only as an investment.

(12) It would have also been useful to better understand paragraph 49 of the VC IG, particularly regarding the reporting requirements and expectations, beyond ESRS E1 *Climate change,* for investments outside the value chain.

OPERATIONAL CONTROL

(13) Accountancy Europe believes that this is one of the cornerstones for the value chain and merits more comprehensive guidance as it involves many considerations.

(14) We suggest EFRAG considers whether it can provide more comprehensive guidance within its remit on this topic, and if not, we suggest EFRAG brings this forward with the EC as we appreciate that this may be a case for interpretation or amendment.

Judgement in different topical standards

(15) We welcome the clarifications in paragraphs 40 – 46 under section "Operational control – E standards" of the VC IG. We appreciate that value chain guidance is quite challenging given that the "operational control" concept per se needs more clarification. We also acknowledge that clarifying this element is challenging as it borders on "interpretation".

(16) Nonetheless, we noticed that paragraph 45 may provide an unintended interpretation when stating that "[…] there may be circumstances where the [operational control] concept should be applied […]". To mitigate this, we suggest EFRAG clearly state that the ESRS E1 *Climate change* operational control provisions stemming from the GHG Protocol are extended only to ESRS E2 *Pollution* and ESRS E4 *Biodiversity and Ecosystems*.

(17) In addition, we suggest clarifying in paragraphs 40 – 42 that the operational control for the purposes of reporting GHG emissions is limited to impacts datapoints only and does not extend to anticipated financial effects datapoints.

(18) We suggest EFRAG provides as many (ideally real life) examples as possible to illustrate the various provisions in different ESRS, which would in turn help align current practices with ESRS provisions. It is important to address and clarify the differences between how value chain is determined in environmental ESRS, with reference to "operational control", and how it works for social ESRS, with reference to "own workforce". For example, it is common practice for companies in the oil/gas, mining, cement industry to report health and safety KPIs when they have a license to operate in a joint venture; effectively, as they follow the GHG Protocol convention, the operational control provisions are applied by default to social topics.

(19) When assessing "own workforce" for the purposes of the social standards, we suggest EFRAG considers that there are legal aspects depending on the provisions of the respective laws in various European Union (EU) countries. For example, it would be useful to have a specific example on how an entity operating in Member State Country A could categorise as "own workforce" workers on a site in Member State Country B in the cases where the entity does not have employment contracts with these people and the legal definitions in both Member States are different.

Determining operational control

(20) We call for more examples to help illustrate how to approach the concepts of operational control, which at this point in time remain very theoretical. Particularly, we would appreciate examples on:

- considerations in view of ESRS E1 *Climate change* and financial reporting (e.g. under the IFRS accounting standards), as these would help better understand the differences in assessments
- other cases where the operational control may go beyond the own reporting boundary, particularly considering that these data may already be covered by another entity's reporting boundary and there is a risk of double reporting
- joint operations as understood in IFRS 11 *Joint Arrangements,* including cases where these arrangements would not be considered within the operational control or for the cases where they would be included, how to account for them (e.g. fully or at a 50%?)
- cases where there could be operational control over a holding where the company may have less than 50% ownership and would not fully consolidate the holding (e.g. an associate), which is an idea that antagonises (familiar) accounting concepts
- cases where subsidiaries are not consolidated in the financial statements because they have been assessed as not material
- cases for leased assets, including considerations with other accounting frameworks that continue to expense operational leases as well as with the GHG Protocol (which also still considers for operational leases that are expensed, and is not aligned with IFRS 16 *Leases*' approach which recognises a right-of-use asset)

- any other items not in the company's balance sheet that would end up being included either with the own operations or the value chain

- how to consider business relationships for entities that hold associates as part of their business model: the guidance suggests leaving out of the value chain, but this would result in a narrower report.

(21) As many of the aforementioned items stem from financial reporting, we suggest EFRAG consider the respective accounting treatment when finalising the guidance to ensure connectivity and as much alignment as possible. Whilst we appreciate that many connectivity considerations in ESRS consider IFRS accounting standards, there will be companies applying ESRS that will apply national accounting standards. Therefore, EFRAG could also consider the Accounting Directive when thinking about connectivity between ESRS and financial standards.

Financial sector

(22) We point out that a very challenging area is applying the "operational control" concept to financial institutions. We understand EFRAG cannot provide more guidance on the matter so not to anticipate of the respective sector-specific standards for financial institutions.

(23) Nonetheless, questions from this sector have already been raised and EFRAG could consider providing as much guidance and illustrative examples in the meantime. This would also help align the different practices that are emerging as well as would help assurance providers.

(24) It is important to clarify the operational control for financed emissions. We understand that the value chain includes the "funding" and the "investing" elements, but it is unclear on how to operationalise it in practice. For example, if a financial institution is state-owned, would the value chain be extended to all the relevant actors the respective government is involved with?

(25) We also suggest aligning "value chain" and "financial institutions" with the final provisions of the Corporate Sustainability Due Diligence Directive (CSDDD), as these two concepts are seen together. For example, as the CSDDD currently stands, there are limitations and exclusions, including the downstream value chain for financial institutions and natural persons. It is important to understand these links and how to include them in the value chain considerations for ESRS purposes.

ALIGNMENT WITH INTERNATIONAL STANDARDS

(26) Whilst we find the VC IG very useful, we regret that the good collaboration with the International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI) when developing the ESRS was not extended to these projects.

(27) Particularly, we believe that the value chain concept is key to the ISSB's standards too, despite recognising that the ISSB has not advanced in providing specific further guidance. Both ESRS and the ISSB standards were aligned to the maximum extent possible and built on the same concept, including that of the operational control assessment under the GHG Protocol.

(28) Therefore, we strongly suggest EFRAG engages with the ISSB and GRI to ensure that their respective guidance, including any future thinking on value chain related matters, are aligned. Alignment of guidance in addition to that of the standards will ensure homogeneous application of the respective standards.

COMMENTS FOR FUTURE CONSIDERATION

(29) We welcome that the VC IG includes separate sections, one on clarifications and the other on FAQ. We also congratulate EFRAG on launching its Q&A platform to support the ESRS implementation. We understand that EFRAG's intent is to regularly publish reports that answer the recurring questions submitted.

(30) Nonetheless, we believe that the FAQs in the VC IG and the Q&As in the platform, may be duplicative and repetitive to the purposes of each of these initiatives as well as create confusion given that the EC has not clarified the status of either of these initiatives. Therefore, we suggest EFRAG reworks some FAQs as simple guidance. Indeed, some see FAQs as having a lower authority than the guidance and not consider them when implementing ESRS. This could raise discussions between the stakeholders in the reporting ecosystem as well as impair comparability.

(31) We believe that in the future, clarifications could be incorporated in the respective ESRS, when the first set is open for revision as these merit respective amendments. The VC IG could therefore serve to explain and illustrate how to make judgements. Should there be any FAQ content in the VC IG that would not be fit as guidance annexed to the ESRS, EFRAG should include them in its work on the Q&A Platform.

(32) It is also important to consider that ESRS reporting will advance as stakeholders gain more experience. However, there is value in sharing good real-life practices as these will help other stakeholders advance too. This could be done via EFRAG's old European Lab, which could be reactivated.

(33) In addition, EFRAG must not lose sight of its main standard-setting duties, including issuing the Basis for Conclusions for the ESRS. Whilst we understand that the standards' Basis for Conclusions are not adopted in law, they are valuable to understand the rationale behind the final standards' provisions. They are also part of the due process and enhance trust in it. Therefore, we encourage EFRAG to collaborate with the EC to update the Basis for Conclusions and include the EC's rationale when making the final changes.

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