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Environment and Affected Communities in the Draft ESRS Issue Paper

Objective

1. The objective of this paper is to propose enhancements to ESRS S3 addressing the connection between environmental matters and affected community-related impacts, risks and opportunities based on feedback received during the public consultation; this is the dependencies concept applied to the state of the environment and affected communities.

Background

2. Art. 19 a) 2 ii) of the Corporate Sustainability Reporting Directive (CSRD) states that the information to be disclosed by undertakings in relation to due diligence shall contain a description of “principal actual or potential adverse impacts connected with the undertaking’s own operations and with its value chain, including its products and services, its business relationships and its supply chain”.
3. The social standards were structured to meet the requirements of the CSRD (ie Art 19 a) 2 e) and Art 29 b) 2 b)) by defining social groups that would be in scope for both social and human rights factors and the due diligence process, this one aligned with the international instruments (UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises and the OECD Due Diligence Guidance for Responsible Business Conduct). Consequently, the social standards have taken a stakeholder-centred approach, focusing on ‘own workforce’ (ESRS S1), ‘workers in the value chain’ (ESRS S2), ‘affected communities’ (ESRS S3), and ‘consumers and and-users’ (ESRS S4).
4. The purpose of ESRS S3 is to enable users to understand how undertakings affect local communities and any actions taken to prevent, mitigate or remediate impacts; as well as gain insights into the risks and opportunities related to the undertaking’s impacts and dependencies on affected communities, and their effects on the undertaking.

5. Undertakings may affect communities and their quality of life through the environmental impacts, risks and opportunities of their own operations, or by means of entities and operations along their value chain. Paragraph AG49 of ESRS S3 provides that undertaking shall take into account practices in relation to planning, land acquisition and exploitation, finances, extraction and or production of raw materials, use of natural resources, and management of environmental impacts.

EFRAG Secretariat analysis

Current ESRS

6. ESRS S3 Affected Communities addresses the connection between the environment and affected communities as part of the Application Guidance connected to DR S3-5 (“Taking action on material impacts on affected communities and effectiveness of those actions”). More specifically, paragraph AG49 reads as follows:

“AG 49. The undertaking shall explain whether and how it ensures that its own practices do not cause or contribute to material negative impacts on local communities, including, where relevant, its practices in relation to planning, land acquisition and exploitation, finance, extraction or production of raw materials, use of natural resources, and management of environmental impacts. This may include explaining what approach is taken when tensions arise between the prevention or mitigation of material negative impacts and other business pressures”.

7. To different extents, a number of environmental standards (E3 and E4) also address the connection with communities.
8. ESRS E3 Water and Marine Resources, as part of the Application Guidance supporting DR E3-3 on Action Plans (para AG20 (b)), includes that “Considering that water and marine resources are shared resources which may require collective actions, or action plans, involving other stakeholders, the undertaking shall specify: [...] (b) if the undertaking is leading a collective action, or action plan, which involves the contribution of other parties (competitors, suppliers, retailers, customers, other business partners, local communities and authorities, government agencies...)”.
9. ESRS E3 Water and Marine Resources also requires undertakings to report on how they have considered sites located in water-stressed areas in their processes to identify and assess water and marine-resources impacts, risks and opportunities, which is critical in terms of impacts on local communities.
10. ESRS E4 Biodiversity and Ecosystems states as part of its objective that the “Standard sets out disclosure requirements related to the undertaking’s relationship to terrestrial, freshwater and marine habitats, ecosystems and populations of related fauna and flora species, including diversity within species, between species and of ecosystems and their interrelation with many indigenous and local communities”.
11. ESRS E4 provides specific requirements that address the link between undertakings’ environmental impacts and the link with communities, including:

- (a) In DR E4-2 (on policies implemented to manage biodiversity and ecosystems), paragraph 24 requires information on policies regarding the social consequences of biodiversity and ecosystems related dependencies and impacts;
- (b) In DR E4-4 (on biodiversity ecosystems and action plans), paragraph 42 requires the disclosure of stakeholders involved in the undertakings' action plans and how they are involved, or/and a list of stakeholders impacted negatively or positively by the stand-alone action or action plan and how they are impacted, including impacts or benefits created for local communities, smallholders, indigenous groups, women, the poor, marginalised and vulnerable groups and individuals;
- (c) In the Application Guidance relating to ESRS 2 on Disclosure Requirements IRO 1 and 2, paragraph 21 (g) indicates that undertakings shall report on the process for conducting consultations with affected local communities regarding the sustainability assessment of shared biological resources and ecosystems as part of their assessment of impacts, risks and opportunities.

Analysis – Proposed Approach

- 12. Feedback received from the public consultation recommends enhancing the ESRS to ensure sufficient clarity and guidance around the disclosure of environmental matters on the one hand, and impacts, risks and opportunities in connection to affected communities on the other hand. Therefore, the proposed drafting will explicitly develop these dependencies with examples and enhance the connection between the environmental standards and ESRS S3.

Feedback from the public consultation

Connection between environment and of affected communities

- 13. Respondents suggest the need to more explicitly require undertakings to explain impacts on the state of the environment (e.g. issues in relation to air, water and soil pollution, degradation of ecosystems, increased flood risks), as they can in turn be very material for communities from a social perspective due to spill over effect (e.g. health issues, access to water - including water of good quality and in sufficient quantities - for households and other uses, real estate prices plummeting, etc.).
- 14. Respondents suggest various sections of ESRS S3 where such enhancement can be made:
 - (a) Under the Objective section;
 - (b) Under paragraph 20 of DR S3-2 on processes for engaging with affected communities about impacts;

- (c) Under paragraph 34 of DR S3-5 on taking action on material impacts on affected communities and effectiveness of those actions;
- (d) Under paragraphs 37-40 of DR S3-6 on approaches to mitigating material risks and pursuing material opportunities related to affected communities;
- (e) Under specific AG paragraphs
 - i) AG 12 “The business risks could also arise because of the undertaking’s dependency on local communities where low likelihood but high impact events may affect the undertaking’s future cash flows, for example, where a natural disaster leads to a catastrophic industrial accident involving the undertaking’s operations, resulting in severe harm to local communities”.
 - ii) AG 49 “The undertaking shall explain whether and how it ensures that its own practices do not cause or contribute to material negative impacts on local communities, including, where relevant, its practices in relation to planning, land acquisition and exploitation, finance, extraction or production of raw materials, use of natural resources, and management of environmental impacts. This may include explaining what approach is taken when tensions arise between the prevention or mitigation of material negative impacts and other business pressures”.
 - iii) AG 57 “In reporting on effectiveness, the undertaking shall enable the understanding of the links between the actions it has taken and the effective management of impacts. For example, to show the effectiveness of its actions to support local communities with improving their environment and living conditions, the undertaking may report survey feedback from the community members showing that conditions have improved since the time the undertaking began addressing these issues. Additional information the undertaking may provide includes data showing a decrease in the number of incidents identified through for instance impact assessments”.
- (f) Others suggest including information of environmental impacts on affected communities under the environmental standards.

Proposed changes

Connection between environment and of affected communities

15. The EFRAG Secretariat recommends enhancing disclosures under ESRS S3; where undertakings report on the impacts of environmental matters of affected communities under relevant environmental standards, undertakings may cross-reference such disclosures.

16. Respondents suggest a number of potential paragraphs in ESRS S3 where the connection between environment and affected communities can be enhanced. For the purpose of clarity and simplification, however, the EFRAG Secretariat suggests centralising enhancements in dedicated sections of the Application Guidance of ESRS S3.
17. More specifically, the EFRAG Secretariat recommends Impact-related enhancements. These complement the requirement to explain how undertakings affect communities through practices linked to e.g. extraction or production of raw materials, use of natural resources, and management of environmental impacts, by providing examples illustrating such a connection.

Existing AG 49 (for context): *The undertaking shall explain whether and how it ensures that its own practices do not cause or contribute to material negative impacts on local communities, including, where relevant, its practices in relation to planning, land acquisition and exploitation, finance, extraction or production of raw materials, use of natural resources, and management of environmental impacts. This may include explaining what approach is taken when tensions arise between the prevention or mitigation of material negative impacts and other business pressures.*

Proposed New AG 50: *From an environmental perspective, impacts on communities may stem from issues covered and reported by undertakings under ESRS E1 to E5. Examples include:*

- *Climate: The implementation of climate change adaptation plans may e.g. require undertakings to invest in renewable energy projects that may affect the ancestral lands, territories and natural resources of indigenous people. In such a scenario, should undertakings fail to properly consult such a community, they would be negatively impacting their right to free, prior and informed consent, and linked to the right to self-determination, the right to freely pursue their economic, social and cultural development. This is one example; such investments can affect the lands, territories and natural resources surrounding areas inhabited by any community.*
- *Pollution: Undertakings can negatively impact communities by e.g. failing to protect citizens from polluting production plants, hence causing health-related issues and affecting their right to an adequate standard of living. Moreover, there is evidence that pollution disproportionately impacts low-income communities and communities of colour, negatively contributing to economic justice and environmental racism.*
- *Water and marine sources: Undertakings may e.g. negatively impact citizens' right to access clean drinking water when failing to manage polluting emissions or when operating and withdrawing water in water stressed areas.*
- *Biodiversity and ecosystem: Undertakings can negatively affect the livelihood of local farmers through e.g. operations that contaminate soil. Additional examples include the sealing of land through building new infrastructure, which can wipe out plan species that are critical for e.g. local biodiversity or to filter water for*

communities, or the introduction of invasive species (whether plants or animals) that can impact entire ecosystems and cause irreversible harm.

- Resource use and circular economy: Undertakings may e.g. negatively impact citizens' right to an adequate standard of living by impacting their health through the mis-management of hazardous waste. Similarly to what has been mentioned under the pollution-related examples, such an impact is often associated with low-income communities and communities of colour, further negatively contributing to economic justice and environmental racism.

Where the connection between environmental impacts and local communities is addressed in ESRS E1-E5, undertakings may cross-reference such disclosures. In the absence of such disclosures under the environmental standards, such information shall be provided under ESRS S3.

18. Risk and opportunity-related enhancements: Including a more explicit indication to report on community-related risks and opportunities arising from the undertakings' impacts and dependencies on the environment, and any actions taken to address them. This will complement the existing indication to report on how undertakings affect communities through practices linked to e.g. extraction or production of raw materials, use of natural resources, and management of environmental impacts.

Existing AG 63 (for context): This Disclosure Requirement focuses on how the undertaking seeks to monitor, manage and mitigate business risks, and pursue business opportunities, related to its impacts or dependencies on affected communities. This disclosure shall include:

- business risks related to an undertaking's impacts on affected communities might include the reputational or legal exposure, as well as operational risks, where local communities protest against resettlements or the loss of access to lands, leading to costly delays, boycotts, or lawsuits;
- business risks related to an undertaking's dependencies on affected communities might include the loss of business continuity where indigenous communities decide to withdraw their consent to a project on their lands, forcing the undertaking to significantly modify or abandon the project;
- business opportunities related to an undertaking's impacts on affected communities might include more easily financing projects and being a partner of choice for communities, governments and other businesses; and
- business opportunities related to an undertaking's dependencies on affected communities might include the development of positive relationships between the undertaking and the indigenous communities that enable existing projects to expand with strong support.

Proposed New AG 64: *In reporting about the above, undertakings shall include explanations of business risks and opportunities stemming from environmental impacts or dependencies (please refer to AG 50 for further details). Examples include reputational risks stemming from indignation regarding the impact on citizen health of unmanaged polluting discharges; or the financial effects of protests that may disrupt or interrupt an undertaking's activities, e.g. in response to operations in water stressed areas that the right to clean water and sanitation of local citizens.*

Questions for EFRAG SR TEG:

19. Does EFRAG SR TEG agree with the approach of enhancing ESRS S3 with examples of such dependencies between the environment and communities?
20. Does EFRAG SR TEG consider that the remaining environmental standards (i.e. Climate, pollution and circular economy) should also have explicit anchor points for these dependencies on affected communities from the state of the environment?
21. Any other comments on this paper