

EXPOSURE DRAFT

ESRS G1

Governance, risk management and internal control

Basis for conclusions

May 2022



DISCLAIMER

This Basis for Conclusions accompanies but is not part of the Exposure Draft ESRS G1 Governance, risk management and internal control. It summarises the considerations of the EFRAG PTF-ESRS and the references to other standard setting initiatives or regulations used in developing the proposed contents of the Exposure Draft.

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Objective

- BC1. The governance and organisation of undertakings in relation to sustainability matters is addressed at cross-cutting level (across all topics) in ESRS 2 General, strategy, governance and materiality assessment.
- BC2. Recital 24 of the [Draft] Corporate Sustainability Reporting Directive (“[Draft] CSRD”) identifies governance as a separate category of sustainability matters, together with environmental and social.
- BC3. As per the [Draft] CSRD, the [Draft] ESRS G1 is prepared with the aim of providing users and other stakeholders with information on the undertaking’s governance structure in general terms, i.e. not limited to the governance in relation to sustainability matters. In particular, investors place significant importance on the quality of decision making in investee companies which derives from their governance structures and processes. Good governance practices have been identified and considered in the preparation of this Draft. This includes disclosures that enable users and other stakeholders to determine whether an undertaking is managed in a way that fosters good decision making, for example through the avoidance of conflicts of interests or groupthink. Good decision making, in turn, enhances the likelihood of long-term issues being taken into account.
- BC4. An undertaking’s governance, business ethics as well as its business management such as risk management and internal control can contribute to the creation of sustainable value for the entity itself and for its stakeholders. For instance, its organisational soundness: the robustness and efficiency of its systems will contribute to business operations continuity and safety; its internal audit and controls will protect it from the negative consequences of all sorts of dysfunctions, from errors to fraud and failure to comply to binding regulations – all causes for value destruction.
- BC5. This [Draft] Standard sets disclosure requirements about general corporate governance of the undertaking (governance structure of the undertaking), as well as its internal control and risk management systems.
- BC6. As provided for in Recital 44 of the [Draft] CSRD, stakeholders need information about governance factors, including information on the role of an undertaking’s administrative, management and supervisory bodies, including with regard to sustainability matters (the latter aspect covered by ESRS 2 General, strategy, governance and materiality assessment), the composition of such bodies, and an undertaking’s internal control and risk management systems, including in relation to the reporting process.
- BC7. Therefore, the [proposed] disclosures requirements in the [Draft] Standard were defined around the following aspects of governance:
- (a) Governance structure;
 - (b) Internal control system;
 - (c) Risk management system.
- BC8. The other governance factors specified by the [Draft] CSRD are covered by ESRS G2 Business conduct.
- BC9. While the [Draft] CSRD refers to governance factors, the [Draft] Standard was named Governance, risk management and internal control to present the topic in a more comprehensive manner.

Context and reference table

- BC10. In accordance with Recital 37 of the [Draft] CSRD, the existing standards and frameworks for sustainability reporting and, where appropriate, accounting, were considered to minimise disruption for undertakings that already report sustainability information (please refer to Annex 1).
- BC11. Furthermore, the degree to which and how other generally accepted frameworks and standards (e.g., GRI, IIRC, TCFD, SASB, CoSo framework) cover the topics of this [Draft] Standard, was also taken into account. Additionally, the requirements/criteria of leading sustainability rating agencies were reviewed to understand market information demands.
- BC12. Overlaps and interlinkages with other EU legislations were assessed to avoid duplication and inconsistency. In this context, the need to include requirements to serve the EU financial sector as required under Recital 47 of the [Draft] CSRD for the first set of ESRS (“That set of reporting standards should specify the information (...) that financial market participants need to comply with the disclosure obligations laid down in Regulation (EU) 2019/2088.”) was also considered.
- BC13. In particular, a gap analysis with the 2021 and 2016 GRI Standards were performed (see below). Moreover, an alignment analysis with the Prospectus Regulation 2017/1129 and the Article 20 “Corporate governance statement” of the Accounting Directive (please refer to Annex 1) was conducted. The Directive 2007/36/EC with reference to the remuneration policy was also considered.
- BC14. The [Draft] Standard focusses on a limited number of well-established disclosures around practices related to governance, risk management and internal control. The proposals of the [Draft] CSRD extend reporting obligations to undertakings who do not currently have reporting or performance obligations to this extent or are unfamiliar with these topics. Therefore, the focus of the [Draft] Standard is those issues and information that are considered to be the most important to all stakeholders. This means that not all the proposals are equally important to all reporting undertakings, and undertakings should provide essential disclosures while not diluting the impact of such disclosures by including other unimportant information.
- BC15. To ensure comprehensive disclosure for undertakings, Article 20 of the Accounting Directive has been considered as a point of reference (see Annex 1):
- (a) undertakings that already disclose information as per art. 20 are expected to incorporate the information by reference to the relevant section of the management report where such information is presented, as allowed by ESRS 1 General principles paragraphs 135 and 136; avoiding in this way the duplication of the required information.
 - (b) at the same time, the undertakings who are not covered by article 20¹ will then produce a comprehensive disclosure, ensuring comparability with other companies.

¹ While the scope of the accounting directive is broad, only those undertakings that are listed have to include a corporate governance statement. Therefore, given the broad scope of the [draft] CSRD, this would cover a wide range of companies.

BC16. The following table presents the mapping of sources of each Disclosure Requirement with EU regulation / global frameworks and other initiatives:

[Draft] ESRS G2 DRs	[Draft] CSRD reference	SFDR reference	References to other frameworks
DR G1-1	Art. 19b 2 (c) (i)		GRI 2-9 Governance structure and composition, GRI 2-11 Chair of the highest governance body Accounting Directive art.20(1)(f)
DR G1-2	Art. 19b 2 (c) (i)		Accounting Directive art.20(1)(a) and (b)
DR G1-3	Art. 19b 2 (c) (i)		GRI 2-10 Nomination and selection of the highest governance body GRI 2-17 Collective knowledge of the highest governance body
DR G1-4	Art. 19b 2 (c) (i)		Accounting Directive art. 20 (1)(g)
DR G1-5	Art. 19b 2 (c) (i)		GRI 2-18 Evaluation of the performance of the highest governance body
DR G1-6	Art. 19b 2 (c) (i)		GRI 2-19 Remuneration policies GRI 2-20 Process to determine remuneration EU Directive 2007/36/EC
DR G1-7	Art. 19b 2 (c) (v)		GRI 1 Foundation
DR G1-8	Art. 19b 2 (c) (v)		GRI 2-14 Role of the highest governance body in sustainability reporting
DR G1-9	Art. 19b 2 (c) (i)	PAI, Indicator 13 of Table 1 of Annex 1	GRI 2-9 Governance structure and composition Accounting Directive art.20(1)(f)
DR G1-10	Art. 19b 2 (c) (i)		

BC17. When drafting this [Draft] Standard it was considered that the provisions from the GRI 2-12, 2-13 and 2-17 are covered by ESRS 1 and ESRS 2, and the related topical standard application guidance paragraphs. ESRS S1 Own workforce has included GRI 2-21. GRI 2-16 on communication of critical concerns was also considered but excluded in order to limit the burden for preparers.

Disclosure Requirements

Strategy and business model, governance and organisation, impacts, risks and opportunities

Disclosure Requirement G1-1 – Governance structure and composition

BC18. The information reported on the tasks assigned to the governance bodies and their responsibilities in relation to the development of strategies and policies is important for understanding how the governance bodies are set up and how well equipped they are to oversee the management of the undertaking, including its sustainability-related impacts, risks and opportunities. It also facilitates an understanding of the role and the responsibilities of governance bodies with respect to these impacts.

- BC19. The independence of the members of the governance bodies allows stakeholders to understand whether judgement is exercised free from any external influence or conflicts of interest.
- BC20. This disclosure requirement encompasses GRI 2-9, 2-11 and the Accounting Directive article 20(1)(f). Entities that report under article 20 of the Accounting Directive are not required to prepare a different disclosure or duplicate it, but to incorporate this information by reference to the relevant paragraphs of the management report where it is presented.

Policies, targets, action plans and resources

Disclosure Requirement G1-2 – Corporate governance code or policy

- BC21. To support transparency, information about Corporate Governance Code or Policy is required in order to understand better which regulatory requirements influence the design of the governance structure. Furthermore, aspects implemented over and above any relevant legal or regulatory requirements are also relevant to stakeholders.
- BC22. The [Draft] Standard is aligned with the Accounting Directive article 20(1)(a) and (b) on this topic. Undertakings that report under article 20 of the Accounting Directive are not required to prepare a different disclosure or duplicate it, but to incorporate this information by reference to the relevant paragraphs of the management report where it is presented.

Disclosure requirement G1-3 - Nomination Process

- BC23. The [proposed] disclosure allows the evaluation of whether the undertaking has a formal, fair and transparent process, and whether it is aligned with the undertaking's policy on diversity, succession planning and with its long-term strategy. The disclosure also explains the mechanism adopted to ensure the balance of professional skills, knowledge, independence and experience of the members of the governance bodies, needed to ensure its long-term success.
- BC24. The [Draft] Standard encompasses GRI 2-10 and GRI 2-17.

Disclosure Requirement G1-4 – Diversity policy

- BC25. Disclosures on diversity policy is increasingly relevant in different national and international context and often the subject of legislation. The objective of the disclosure is to provide an overview on the undertaking internal policy, its implementation and the results obtained. This is key information to ensure effective, equitable and inclusive decision-making in alignment with the undertaking's purpose and taking into consideration the interests of relevant stakeholders.
- BC26. The guidance to GRI 2-9-c allows the optional description of diversity indicators, but the requirements in G1-4 is the same as required by article 20(1)(g) of the Accounting Directive. Entities that report under article 20 of the Accounting Directive are not required to prepare a different disclosure or duplicate it, but to incorporate this information by reference to the relevant paragraphs of the management report where it is presented.

Disclosure Requirement G1-5 – Evaluation process

- BC27. The disclosure provides an overview on the assessment the undertaking's governance bodies and the process how it continually improves itself. It provides to stakeholders the necessary information to understand if the undertaking has a robust evaluation process, that results in the appropriate (new) skills, perspectives and strategies needed over time. Investors increasingly regard the review process and its disclosure as key opportunities to enhance board effectiveness and shareholder value.
- BC28. This disclosure requirement is consistent with GRI 2-18.

Disclosure requirement G1-6 – Remuneration policy

- BC29. The [Draft] Standard focuses on the undertaking's remuneration policy, to explain how remuneration systems are aligned with company's objectives and values, long term strategies, and at the same time embed sound risk management practices.
- BC30. This is important to understand how remuneration and incentives ensure that management deliver on the key performance indicators linked to the strategic objectives of the company. The disclosure covers all aspects of pay and incentives and how it links to both financial and sustainability performance indicators.
- BC31. This disclosure requirement is consistent with GRI 2-19 and 2-20.
- BC32. This disclosure requirement requires information already provided by the remuneration report (EU Directive 2007/36/EC). However, the remuneration report is only required of undertakings with their registered office in a member state that are listed in a member state. It is possible to incorporate by reference into the sustainability statement, information presented in other sections of the management report (see paragraphs 135 and 136 of ESRS 1).

Disclosure requirement G1-7 – Risk management

- BC33. Information about general risk management improves the credibility of sustainability reporting and supports users' understanding of how the entity is exposed and how effectively it manages its material sustainability impacts, risks and opportunities.
- BC34. While more detailed disclosures on these topics may be required in sector-specific standards, this [Draft] Standard creates a starting point for disclosures about the undertaking's process in this regard. This information is useful and relevant to stakeholders in order to monitor robustness of contingency and resilience planning for risk threats and opportunities. It can help the evaluation of whether the undertaking has implemented an effective and dynamic ongoing process to identify risks, measure their potential outcomes, and proactively manage those risks to the extent appropriate. For undertakings and stakeholders alike, risk taking is an inseparable element of strategy and a crucial driver in achieving objectives, including optimising value over time. Risk is part of every decision an undertaking makes.

- BC35. Stakeholders can use the reported information to assess an organization's risks and opportunities and how it integrates them in its business strategy and model. They can also use disclosures on description of risks and opportunities relevant for strategy, the associated impacts, their likelihood, actions taken to prevent and mitigate the principal risks. This ensures that undertakings have robust and effective risk management which should address all key risks and opportunities related to the organisation's business and to assess its long-term success. This would refer to the risks other than those arising from sustainability matters which are covered under ESRS 2.
- BC36. Moreover, the requirement provides disclosure on how governance bodies are responsible for overseeing the risk management process including its recognition, prioritisation and effective mitigation and responses to risks. It demonstrates how governance bodies maintain an active and alert attitude to emerging and unforeseen risks.
- BC37. A corresponding requirement in GRI could not be identified.
- BC38. This disclosure requirement is the same as required by article 20(1)(c) of the Accounting Directive. Entities that report under article 20 of the Accounting Directive are not required to prepare a different disclosure or duplicate it, but to incorporate this information by reference to the relevant paragraphs of the management report where it is presented.

Disclosure requirement G1-8 – Internal control processes

- BC39. Information about internal control processes improves the credibility of sustainability reporting and supports users' understanding of how the entity is exposed and how effectively it manages its material sustainability impacts, risks and opportunities.
- BC40. Disclosures on the establishment of rigorous, independent, and effective internal control system is key to understand the undertaking's design of processes to various aspects. These include minimisation of risk and the protection of assets, ensuring accuracy of records, promoting operational efficiency, and encouraging adherence to policies, rules, regulations, and law. This includes the internal control system over the sustainability reporting process and if there is any review and approval process over reporting in place under the responsibility of the governance bodies.
- BC41. For stakeholders, the disclosure provides useful information to evaluate the level of the achievement of operational objectives, such as the effectiveness and efficiency of operations and compliance with applicable laws and regulations.
- BC42. This disclosure requirement also requires a description of the internal controls over the sustainability reporting, as this aspect is mentioned explicitly in the CSRD as one of the governance factors to be covered in ESRS (article 19b 2 (c) (v)).
- BC43. A corresponding requirement in GRI covering internal controls in general could not be identified, however GRI 2-14 requires disclosures of the role of the highest governance body in sustainability reporting and in this respect this disclosure requirement is consistent with GRI 2-14. The Accounting Directive covers the same, but only with reference to financial reporting.

Performance measures

Disclosure Requirement G1-9 – Composition of the administrative, management and supervisory bodies

- BC44. The composition of governance bodies (and its committees) allows to understand if the organisation has an appropriate combination of members with relevant knowledge, independence, competence, industry experience and diversity of perspectives. These will help to generate effective challenge, discussion, and objective decision-making in alignment with the undertaking's purpose, long-term strategy and relevant stakeholders.
- BC45. This disclosure requirement is consistent with GRI 2-9 Governance and the Accounting Directive art.20(1)(f).

Disclosure Requirement G1-10 Meetings and attendance rate

- BC46. Attendance by members of the administrative, management and supervisory bodies and committees are essential to reach required quorums. The successful functioning of these bodies and committees also depends on the attendance of its members to allow the undertaking to utilise their experience, knowledge and skills to the full. Therefore, this disclosure which is currently done on a voluntary basis by some undertakings have been incorporated here as mandatory (subject to the rebuttable presumption in ESRS 1 paragraph 57) to allow stakeholders to incorporate this information in their evaluation of the governance bodies and their members.
- BC47. A corresponding requirement in GRI could not be identified.

Annex 1: Comparison of G1 with Article 20 ‘Corporate governance statement’ of the Accounting Directive²

Article	Topic	Requirements	Alignment with [Draft] ESRS G1
Art. 20(1)(a) Art. 20(1)(b)	Corporate governance code	<p>1. Undertakings referred to in point (1)(a) of Article 2 shall include a corporate governance statement in their management report. That statement shall be included as a specific section of the management report and shall contain at least the following information:</p> <p>(a) a reference to the following, where applicable:</p> <p>(i) the corporate governance code to which the undertaking is subject,</p> <p>(ii) the corporate governance code which the undertaking may have voluntarily decided to apply,</p> <p>(iii) all relevant information about the corporate governance practices applied over and above the requirements of national law.</p> <p>Where reference is made to a corporate governance code referred to in points (i) or (ii), the undertaking shall also indicate where the relevant texts are publicly available. Where reference is made to the information referred to in point (iii), the undertaking shall make details of its corporate governance practices publicly available.</p> <p>(b) where an undertaking, in accordance with national law, departs from a corporate governance code referred to in points (a)(i) or (ii), an explanation by the undertaking as to which parts of the corporate governance code it departs from and the reasons for doing so; where the undertaking has decided not to refer to any provisions of a corporate governance code referred to in points (a)(i) or (ii), it shall explain its reasons for not doing so;</p>	<p>Yes.</p> <p>See paragraphs 15-18.</p>
Art. 20(1)(c)	Internal control and	(c) a description of the main features of the undertaking's internal control	Internal control and risk management

² DIRECTIVE 2013/34/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

Article	Topic	Requirements	Alignment with [Draft] ESRS G1
	risk management systems	and risk management systems in relation to the financial reporting process;	systems in ESRS G1 are not related to the financial reporting process. See paragraphs 34-40.
Art. 20(1)(d)	Bids	(d) the information required by points (c), (d), (f), (h) and (i) of Article 10(1) of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, where the undertaking is subject to that Directive;	This information is out of the scope of [Draft] ESRS G1.
Art. 20(1)(e)	Shareholding	(e) unless the information is already fully provided for in national law, a description of the operation of the shareholder meeting and its key powers and a description of shareholders' rights and how they can be exercised;	This information is out of the scope of [Draft] ESRS G1.
Art. 20(1)(f)	Composition of governance bodies	(f) the composition and operation of the administrative, management and supervisory bodies and their committees; and	Yes. See paragraph 14 and paragraphs 41-45.
Art. 20(1)(g)	Diversity policy	(g) a description of the diversity policy applied in relation to the undertaking's administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented and the results in the reporting period. If no such policy is applied, the statement shall contain an explanation as to why this is the case.	Yes. See paragraphs 22-26.
Art. 20(2)	Publication of information	2. Member States may permit the information required by paragraph 1 of this Article to be set out in: (a) a separate report published together with the management report in the manner set out in Article 30; or (b) a document publicly available on the undertaking's website, to which reference is made in the management report. That separate report or that document referred to in points (a) and (b), respectively, may cross-refer to the	Not applicable. Disclosure related to the publication of the information.

Article	Topic	Requirements	Alignment with [Draft] ESRS G1
		management report, where the information required by point (d) of paragraph 1 of this Article is made available in that management report.	
Art. 20(3)	Assurance	3. The statutory auditor or audit firm shall express an opinion in accordance with the second subparagraph of Article 34(1) regarding information prepared under points (c) and (d) of paragraph 1 of this Article and shall check that the information referred to in points (a), (b), (e), (f) and (g) of paragraph 1 of this Article has been provided.	Not applicable. Disclosure related to the assurance of the information.
Art. 20(4)	Member State exemption	4. Member States may exempt undertakings referred to in paragraph 1 which have only issued securities other than shares admitted to trading on a regulated market within the meaning of point (14) of Article 4(1) of Directive 2004/39/EC from the application of points (a), (b), (e), (f) and (g) of paragraph 1 of this Article, unless such undertakings have issued shares which are traded in a multilateral trading facility within the meaning of point (15) of Article 4(1) of Directive 2004/39/EC.	Not applicable. Disclosure related to the scope.
Art. 20(5)	SMEs	5. Notwithstanding Article 40, point (g) of paragraph 1 shall not apply to small and medium-sized undertakings.	Not applicable.



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