VI.

STAKEHOLDER ENGAGEMENT IN THE ESRS

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What you will learn:
Engagement with stakeholders is an important requirement of the ESRS, but its purpose and the different processes that should be followed by companies are frequently misunderstood. This article explores the ESRS’ approach to stakeholder engagement, squaring the requirements with existing expectations of human rights due diligence and providing clear recommendations to help companies create cohesive, effective and streamlined stakeholder engagement processes for reporting and due diligence.

1. UNDERSTANDING THE MAIN GROUPS OF STAKEHOLDERS

ESRS 1 explains that “stakeholders are those who can affect or be affected by the undertaking” and that they fall into two main groups for the purposes of reporting: affected stakeholders and users of sustainability statements.¹

The first group – affected stakeholders – are the people who are, or could be, impacted by a company’s activities and its business relationships across its value chain. It includes employees, workers in the value chain, communities, consumers and end-users, as per the four key groups of stakeholders covered by the social standards.

The second group are users of sustainability statements, or what one might consider “disclosure stakeholders.” As defined in ESRS 1, they include primary users of financial reporting (such as investors and lenders) and other users of sustainability statements (such as trade unions, NGOs, governments, analysts, academics, etc.).

The ESRS clarify that “some, but not all, stakeholders may belong to both groups.”² Employees, trade unions and consumers can all be seen as belonging to both – as well as some NGOs, such as human rights defending...
organizations whose staff may themselves be victims of human rights abuses, such as violations to their freedom of expression or attacks on their person.

2. THE ROLE OF AFFECTED STAKEHOLDER ENGAGEMENT IN THE MATERIALITY ASSESSMENT PROCESS

Section 3.1 of ESRS 1 outlines the role of engagement with affected stakeholders in the materiality assessment process. This section is key to understanding the relationship between stakeholder engagement in the context of due diligence and reporting. Paragraph 24 states:

“Engagement with affected stakeholders is central to the undertaking’s ongoing due diligence process […] and sustainability materiality assessment. This includes its processes to identify and assess actual and potential negative impacts, which then inform the assessment process to identify the material impacts for the purposes of sustainability reporting” [emphasis added].

In other words, affected stakeholders must be engaged as part of the human rights due diligence process “to understand how they may be impacted” through the lens of risk to people, rather than risk to the business. The results of this due diligence process then inform the identification of material impacts for reporting.

Indeed, the ESRS do not require affected stakeholders to be engaged in decisions on what should be considered material across the business as a whole. For example, it would likely be inappropriate and unwelcome to ask members of a community affected by a single mining operation to provide input regarding the parent company’s global materiality assessment. It is when the affected stakeholder engagement process is tied to due diligence – to identifying, preventing and addressing human rights impacts – that the engagement serves its rightful purpose.

3. THE DIFFERENT PURPOSES OF STAKEHOLDER ENGAGEMENT IN THE ESRS

The materiality assessment process laid out by the ESRS is a fundamental shift from traditional approaches to impact materiality: it is no longer a perception-based exercise. The common practice of sending an impact materiality survey to stakeholders (usually expert consultants, NGOs, academics and similar) asking them to rate the relevance of topics often leads to incoherent, ill-informed results that are skewed towards the interests and agendas of those interviewed. The ESRS instead propose that companies stress test their own conclusions on the materiality of impacts, based on
an analysis of their relative severity, with stakeholders and experts who can provide the required feedback. This should be done with a view to ensuring that the underlying assessment process and resulting conclusions regarding material impacts are sound and robust.

This is reflected in the application requirements for section 3.1 of ESRS 1. AR 8 states that a company “may engage with affected stakeholders or their representatives (such as employees and trade unions), along with users of sustainability reporting and other experts, to provide inputs or feedback on its conclusions regarding its material impacts, risks and opportunities.” Here, alongside other report users and experts, the example of “employees and trade unions” reflects those groups of potentially affected stakeholders that are at the intersection of affected stakeholders and disclosure stakeholders.

**But stakeholder engagement in the ESRS goes beyond the identification of material impacts.** For instance, the Strategy and Business Model disclosure SBM-2 in ESRS 2 asks that companies disclose how the interests and views of their stakeholders are taken into account by their companies’ strategy and business model(s). The required disclosures include a summarized description of the company’s stakeholders, how the engagement is organized, its purpose, how the company has amended or expects to amend its strategy and/or business model(s) to address the interests and views of its stakeholders, as well as whether and how the company’s governing bodies are informed about the views of affected stakeholders with regard to the company’s sustainability-related impacts.

Some of the other disclosures concerning engagement with stakeholders include:

- **How engagement informs the company’s awareness and assessment of impacts** (S1/S2/S3/S4-2, Processes for engaging with [affected stakeholders] about impacts

- **How engagement informs the company’s policies** (MDR-Policies, Policies adopted to manage material sustainability matters, para. 65)

- **How engagement informs the company’s targets** (MDR-Targets, Tracking effectiveness of policies and actions through targets, para. 79)

- **Affected stakeholders as “beneficiaries” of the company’s actions to address material sustainability matters** (MDR-Actions, Actions and resources in relation to material sustainability matters, para. 68)

- **Affected stakeholders as users of channels to raise concerns** (S1/S2/S3/S4-3, Processes to remediate negative impacts and channels for [affected stakeholders] to raise concerns).
4. A CLEAR VISION FOR STAKEHOLDER ENGAGEMENT, WHETHER OR NOT YOU ARE ALREADY CONDUCTING HUMAN RIGHTS DUE DILIGENCE

In sum, the ESRS make clear that the identification of impacts in the context of human rights due diligence should inform the identification of material impacts for reporting. If you are already conducting due diligence in your own operations and value chain, then the materiality assessment process should be straightforward: your “salient” human rights issues (i.e. the most severe impacts connected with your business) constitute the pool of issues from which to assess whether all, or a sub-set, are material for reporting.

On the other hand, if your company has not yet conducted due diligence, the impact materiality assessment will be informed, as much as possible, by external conversations with disclosure stakeholders, experts, and some employees and trade unions on key issues. The point is to first reach your best internal analysis of the severity of impacts, before testing it with human rights experts, pertinent investors, NGOs and others. They may not be able to speak to the experiences of affected stakeholders on the ground, but they should still be in a position to stress test the materiality assessment results. To do so effectively, you will need to share information about the company’s activities, countries of operation, business relationships, business model and existing risk and materiality assessments, etc., where this is not already known. Without this, even expert inputs risk remaining rather high-level and insubstantial.
ENDNOTES

1 ESRS 1, para. 22.
2 ESRS 1, para. 23.
3 ESRS 1, para. 24.
4 ESRS 2, IRO-1 para. 53 (b) (iii).
5 ESRS 1, AR 8.
6 ESRS 2, SBM-2, para. 43.
7 See the first article in this series, Double Materiality: What you need to know for more detail.
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