

EXPOSURE DRAFT

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## **ESRS G1**

# **Governance, risk management and internal control**

April 2022



Open for comments until 8 August 2022

**PTF-ESRS**

Project Task Force on European sustainability reporting standards

 **EFRAG**

## **DISCLAIMER**

This Exposure Draft has to be read in conjunction with the cover note for ESRS public consultation. It has been prepared under the sole responsibility of the EFRAG PTF-ESRS and is submitted to public consultation by EFRAG SRB to inform the upcoming standard-setting steps. It therefore does not reflect the EFRAG SRB's position at this stage, nor the position of the European Union or European Commission DG Financial Stability, Financial Services and Capital Markets Union (DG FISMA), nor the position of organisations with which the EFRAG PTF-ESRS has cooperated. The final version of the [draft] Standard will be produced by the EFRAG SRB starting from this Exposure Draft, taking into consideration the outcome of the public consultation and the requirements of the final CSRD.

[Draft] ESRS G1 Governance, risk management and internal control is set out in paragraphs 1-48 and Appendices A: Defined terms and B: Application Guidance. All the paragraphs, including those in the Appendices, have equal authority. Each Disclosure Requirement objective is stated in a bold paragraph, followed by a paragraph that illustrates the principle to be followed in the preparation of the respective disclosures. The [draft] Standard also uses terms defined in other [draft] ESRS and should be read in the context of its objective.

## Table of contents

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<b>Objective</b>	<b>4</b>
<b>Interaction with other ESRS</b>	<b>4</b>
<b>Disclosure Requirements</b>	<b>5</b>
<b>Strategy and business model, governance and organisation, Impacts, risks and opportunities</b>	<b>5</b>
<b>Disclosure Requirement G1-1 – Governance structure and composition</b>	<b>5</b>
<b>Policies, targets, action plans and resources</b>	<b>6</b>
<b>Disclosure Requirement G1-2 – Corporate governance code or policy</b>	<b>6</b>
<b>Disclosure Requirement G1-3 – Nomination process</b>	<b>6</b>
<b>Disclosure Requirement G1-4 – Diversity policy</b>	<b>7</b>
<b>Disclosure Requirement G1-5 – Evaluation process</b>	<b>7</b>
<b>Disclosure Requirement G1-6 – Remuneration policy</b>	<b>8</b>
<b>Disclosure Requirement G1-7 – Risk management processes</b>	<b>8</b>
<b>Disclosure Requirement G1-8 – Internal control processes</b>	<b>9</b>
<b>Performance measurement</b>	<b>9</b>
<b>Disclosure Requirement G1-9 – Composition of the administrative, management and supervisory bodies</b>	<b>9</b>
<b>Disclosure Requirement G1-10 – Meetings and attendance rate</b>	<b>10</b>
<b>Appendix A: Defined terms</b>	<b>11</b>
<b>Appendix B: Application guidance</b>	<b>12</b>
<b>Strategy and business model, governance and organisation, Impacts, risks and opportunities</b>	<b>12</b>
<b>Disclosure Requirement G1-1 – Governance structure and composition</b>	<b>12</b>
<b>Policies, targets, action plans and resources</b>	<b>13</b>
<b>Disclosure Requirement G1-2 – Corporate governance code or policy</b>	<b>13</b>
<b>Disclosure Requirement G1-3 – Nomination process</b>	<b>13</b>
<b>Disclosure Requirement G1-4 – Diversity policy</b>	<b>13</b>
<b>Disclosure Requirement G1-6 – Remuneration policy</b>	<b>13</b>
<b>Disclosure Requirement G1-7 – Risk management processes</b>	<b>14</b>
<b>Disclosure Requirement G1-8 – Internal control processes</b>	<b>15</b>
<b>Performance measurement</b>	<b>15</b>
<b>Disclosure Requirement G1-9 – Composition of the administrative, management and supervisory bodies</b>	<b>15</b>

## Objective

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1. The objective of this [draft] Standard is to specify disclosure requirements which will enable users of the undertaking's sustainability statements to understand the governance structure of the undertaking, and its internal control and risk management systems.
2. The requirements, in this [draft] Standard, are intended to provide information that reinforces users' understanding of the undertaking's impacts on people and the environment and the effects of risks and opportunities, related to the undertaking's impacts and dependencies on people and the environment, on the undertaking's development, performance and position over the short, medium and long term and therefore on its ability to create enterprise value.
3. This [draft] Standard derives from the [Draft Corporate Sustainability Reporting Directive] stating that the sustainability reporting standards shall specify information to disclose about governance factors, including: (i) the role of the undertaking's administrative, management and supervisory bodies, including with regard to sustainability matters, and their composition, as well as a description of the diversity policy applied and its implementation; and (ii) the undertaking's internal control and risk management systems, including in relation to the undertaking's reporting process.
4. ESRS 2 General, strategy, governance and materiality assessment prescribes disclosure requirements for the description of the undertaking's governance and organisation in relation to sustainability matters. Topical Standards prescribe disclosure requirements that cover (i) policies, targets, action plans and resources and (ii) performance measurement in relation to specific topics. Accordingly, this [draft] Standard focuses on the undertaking's overall governance, risk management and internal control.
5. In order to promote effective communication and avoid duplication, where the disclosures required by this [draft] Standard are provided in full or in part in another section of the undertaking's management report the undertaking may in its sustainability include them by reference, provided that such disclosures do constitute a separate element of information clearly identified in the other section of the management report as addressing the relevant disclosure requirement in this [draft] Standard (or the relevant specific datapoint mandated by a disclosure requirement of it). In particular, paragraph 5 of article 1 of the [Draft Corporate Sustainability Reporting Directive] amends the Accounting Directive to allow listed undertakings to report the information about internal control and risk management systems in relation to:
  - (a) financial reporting process;
  - (b) the composition and operation of the administrative, management and supervisory bodies; and
  - (c) the diversity policy applied in relation to the undertaking's administrative, management and supervisory bodies.
6. The [Draft Corporate Sustainability Reporting Directive] allows undertakings to report these disclosures as part of sustainability statements, overcoming the risk of duplication.

## Interaction with other ESRS

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7. The content of this Standard on Strategy and business model, Governance and organisation and Impacts, risks and opportunities, as well as Policies, targets, action

plans and resources shall be read in conjunction respectively with ESRS 1 General Principles and ESRS 2.

8. This [draft] Standard shall also be applied in conjunction with the [draft] Standards on environmental and social topics ([draft] ESRS E1 Climate change to [draft] ESRS E4 Biodiversity and ecosystems, and [draft] ESRS S1 Own workforce to [draft] ESRS S4 Affected communities) where they prescribe disclosures on the governance structure of the undertaking and its internal control and risk management systems, with respect to specific environmental or social features. Those disclosures shall be considered as complementary to the disclosures provided under this [draft] Standard, which focuses on the general aspects of governance.
9. This [draft] Standard covers sector-agnostic disclosure requirements. Sector-specific disclosure requirements are prescribed separately and in accordance with the classification specified by [draft] ESRS SEC 1 Sector classification<sup>1</sup>.

## **Disclosure Requirements**

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### ***Strategy and business model, governance and organisation, Impacts, risks and opportunities***

10. The provisions of this [draft] Standard shall be read in conjunction with and reported alongside the disclosure requirements of ESRS 2.
11. This [draft] Standard includes a topic-specific disclosure requirement, ESRS G1 Disclosure Requirement 1 on Governance structure and composition.

### ***Disclosure Requirement G1-1 – Governance structure and composition***

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12. The undertaking shall provide information on its governance structure and composition.
13. The principle to be followed under this Disclosure Requirement is to provide an understanding of the structure and composition of the governance and the distribution of roles and responsibilities throughout the undertaking's organisation, from its administrative, management and supervisory bodies to its executive and operational levels.
14. The disclosure required by paragraph 12 shall include:
  - (a) a description of the structure of its governance body and the roles and key responsibilities of each of its committees;
  - (b) identity of members of the governance body;
  - (c) classification of members between executive and non-executive;
  - (d) independence of members;
  - (e) tenure of members on the governance body;
  - (f) for each member the number of significant positions and commitments, and the nature of the commitments;
  - (g) representation of stakeholder groups; and
  - (h) competencies relevant to the sector, products and geographic locations of the undertaking and associated regulation.

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<sup>1</sup> to be issued at a later stage

## **Policies, targets, action plans and resources**

### **Disclosure Requirement G1-2 – Corporate governance code or policy**

15. The undertaking shall disclose the corporate governance code, policy or practices that determine the function of its administrative, management or supervisory bodies.
16. The principle to be followed under this Disclosure Requirement is to provide information about any legal or regulatory requirements that mandate and influence the design of the governance structure of the undertaking, together with information on aspects implemented that are over and above any relevant legal or regulatory requirements.
17. The disclosure required by paragraph 15 shall include the following information:
  - (a) the corporate governance code to which the undertaking is subject or which the undertaking may have voluntarily decided to apply, with an indication of where the relevant texts are publicly available;
  - (b) all relevant information about the corporate governance practices applied over and above the requirements of national law, including details of where the undertaking's corporate governance practices are publicly available.
18. Where an undertaking, in accordance with national law, departs from a corporate governance code referred to in paragraph 17(a), it shall provide an explanation 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 paragraph 17(a), it shall explain its reasons for not doing so.

### **Disclosure Requirement G1-3 – Nomination process**

19. The undertaking shall provide information about the nomination and selection processes for its administrative, management and supervisory bodies.
20. The principle to be followed under this Disclosure Requirement is to provide information about the criteria used for selecting and nominating the members of the undertaking's administrative, management and supervisory bodies.
21. The disclosure required by paragraph 19 shall include the following information:
  - (a) a description of the nomination and selection processes for the administrative, management and supervisory bodies and, where applicable, their committees;
  - (b) a description of the criteria used for nominating and selecting the members of the administrative, management and supervisory bodies, including whether and how:
    - i. stakeholders (including shareholders) are involved in the nomination process;
    - ii. diversity is considered in the selection process;
    - iii. independence is considered in the selection process; and
    - iv. competencies relevant to the sector of the undertaking are considered in the selection process.

### ***Disclosure Requirement G1-4 – Diversity policy***

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22. The undertaking shall provide information on the diversity policy applied in relation to its administrative, management and supervisory bodies.
23. The principle to be followed under this Disclosure Requirement is to provide information about the undertaking's diversity policy to promote a diversified composition of its administrative, management and supervisory bodies. This shall also include the diversity criteria adopted with the associated rationale on their prioritisation, and the mechanism adopted to foster diversity representation.
24. The disclosure required by paragraph 22 shall include the following information:
  - (a) a description of the diversity policy applied in relation to the undertaking's its administrative, management and supervisory bodies with regard to each of the following:
    - i. gender,
    - ii. age,
    - iii. minority or vulnerable groups,
    - iv. educational and professional backgrounds, and
    - v. other aspects where relevant.
  - (b) the objectives of that diversity policy.
  - (c) how the diversity policy has been implemented.
25. If no such policy is applied, the undertaking shall provide an explanation as to why this is the case and, where applicable, the timing and plans to apply a diversity policy.
26. The disclosure shall also specify the following:
  - (a) whether there are legal and regulatory requirements that mandate diversity representation in the composition of the undertaking's administrative, management and supervisory bodies, and if so, a reference to those requirements;
  - (b) whether the diversity representation implemented in the composition of the undertaking's administrative, management and supervisory bodies is over or above any relevant legal and regulatory requirements; and
  - (c) any targets set, mandated or voluntary, for each diversity classification in the composition of the undertaking's its administrative, management and supervisory bodies and progress made against those targets.

### ***Disclosure Requirement G1-5 – Evaluation process***

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27. The undertaking shall describe the process, if any, followed for evaluating the performance of its administrative, management and supervisory bodies in overseeing the management of the undertaking.
28. The principle to be followed under this Disclosure Requirement is to provide transparency on the process implemented by the undertaking for the evaluation of the performance of its administrative, management and supervisory bodies in supervising the management of the undertaking.

29. The disclosure required by paragraph 27 shall include a description of:
- (a) the process followed for evaluating the performance of its administrative, management and supervisory bodies;
  - (b) whether the evaluation is independent or not, and its frequency; and
  - (c) the actions taken in response to the evaluation of the performance of the administrative, management and supervisory bodies.

#### ***Disclosure Requirement G1-6 – Remuneration policy***

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30. The undertaking shall describe the policy used for the remuneration of its administrative, management and supervisory bodies.
31. The principle to be followed under this Disclosure Requirement is to provide information about the undertaking's policy for the remuneration of the administrative, management and supervisory bodies.
32. The disclosure required by paragraph 30 shall include information regarding the process followed in determining the policy and proposals for the remuneration of the undertaking's administrative, management and supervisory bodies, in particular:
- (a) the assigned roles and responsibilities for the process, including whether the process is overseen by independent members of the undertaking's governance body or an independent remuneration committee;
  - (b) whether external consultants are involved;
  - (c) whether stakeholders' views (including shareholders) are sought and taken into account, together with any corresponding voting results.
33. The disclosure required by paragraph 32 shall address specifically the following types of remuneration:
- (a) fixed pay and variable pay, including performance-based pay, equity-based pay, bonuses, and deferred or vested shares;
  - (b) sign-on bonuses or recruitment incentive payments;
  - (c) termination payments;
  - (d) clawbacks; and
  - (e) retirement benefits.

#### ***Disclosure Requirement G1-7 – Risk management processes***

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34. The undertaking shall provide information on its risk management processes, with regards to risk arising for the undertaking and for the stakeholders.
35. The principle to be followed under this Disclosure Requirement is to inform about the undertaking's risk management processes. This includes an understanding of the supervision and monitoring of risk management by the undertaking's administrative, management and supervisory bodies.
36. This Disclosure Requirement refers to the process of risk management applied by undertaking in order to identify the risks to which it is exposed due to its strategy and business model.
37. The disclosure required by paragraph 34 shall include information on the risk management process, in terms of:

- (a) the undertaking's risk assessment approach;
- (b) the risk prioritisation methodology;
- (c) the scope, main features and components of its risk management processes, including a description of how the undertaking integrates the findings of its risk assessment for the key risks into relevant internal functions and processes;
- (d) a description of the periodic reporting on risk management to the administrative, management and supervisory body.

### ***Disclosure Requirement G1-8 – Internal control processes***

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- 38. The undertaking shall provide information on its internal control processes, including in relation to the sustainability reporting process.
- 39. The principle to be followed under this Disclosure Requirement is to inform about the aspects related to the governance factors that affect the undertaking's internal control processes, including in relation to sustainability reporting. This also includes an understanding of the supervision and monitoring of those processes by the undertaking's administrative, management and supervisory bodies.
- 40. The disclosure required by paragraph 38 shall include information on:
  - (a) the scope, main features and components of the undertaking's internal control process;
  - (b) a description of the periodic reporting on internal control processes to the administrative, management and supervisory bodies;
  - (c) the main features of the undertaking's internal control systems over the reporting process, including the process for reviewing and approving the information included in the sustainability reporting by the administrative, management and supervisory bodies.

### ***Performance measurement***

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

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- 41. The undertaking shall provide information about the composition of its administrative, supervisory and management bodies.
- 42. The principle to be followed under this Disclosure Requirement is to provide information about the diversity of the members of its administrative, management and supervisory bodies and committees.
- 43. The information in paragraph 41 shall include:
  - (a) percentage of independent shareholder-elected members;
  - (b) percentage of each of the following diversity classifications:
    - i. gender;
    - ii. age group;
    - iii. any other relevant diversity indicators.

44. The Board's<sup>2</sup> gender diversity should be calculated as an average ratio of female to male board members expressed as a percentage of all board members.
45. The disclosure shall include information on changes to the composition of the administrative, management and supervisory bodies of the undertaking from the previous reporting period, including with respect to diversity, with the associated reasons.

***Disclosure Requirement G1-10 – Meetings and attendance rate***

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46. The undertaking shall provide information about the number of meetings and the attendance rate for its administrative, management and supervisory bodies and committees.
47. The principle to be followed under this Disclosure Requirement is to provide information about the rate of participation in meetings of the members of the administrative, management and supervisory bodies and committees.
48. The disclosure required by paragraph 46 shall include the following information:
  - (a) the number of meetings of the undertaking's administrative, management and supervisory bodies and their committees in the reporting period; and
  - (b) the number of members who participated at each meeting in the reporting period.

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<sup>2</sup> This information supports the information needs of financial market participants subject to Regulation (EU) 2019/2088 as reflecting an additional principal adverse impact set out in Table 1 of Annex 1 of the related Delegated Regulation with regard to disclosures rules on sustainable investments.

## **Appendix A: Defined terms**

This appendix is an integral part of the [draft] ESRS G1 Governance, risk management and internal control.

<b>Governance body</b>	See administrative, management and supervisory bodies in ESRS 2.
<b>Remuneration</b>	Basic salary plus additional amounts paid to a worker. Examples of additional amounts paid to a worker can include those based on years of service, bonuses including cash and equity such as stocks and shares, benefit payments, overtime, time owed, and any additional allowances, such as transportation, living and childcare allowances.
<b>Vulnerable group</b>	Set or subset of individuals with some specific physical, social, political, or economic condition or characteristic that places them at a higher risk of suffering a burden, or at a risk of suffering a disproportionate burden, of the social, economic or environmental impacts of the undertaking's operations. Vulnerable groups can include children and youth, the elderly, people with disabilities, ex-combatants, the internally displaced, refugees or returning refugees, HIV/AIDS-affected households, indigenous peoples, and ethnic minorities. Vulnerabilities and impacts can differ by gender.

## **Appendix B: Application guidance**

This appendix is an integral part of the proposed [draft] ESRS G1 Governance, risk management and internal control. It describes how to apply the disclosure requirements set forth in paragraphs 1 to 48 and has the same authority as the other parts of the [draft] Standard. More specifically, it provides further background information on what should be disclosed and describes how it should be disclosed.

### ***Strategy and business model, governance and organisation, Impacts, risks and opportunities***

#### **Disclosure Requirement G1-1 – Governance structure and composition**

- AG 1. The undertaking is expected to provide a concise description of its highest decision-making authority, including the body(ies) that exercise the administrative, management and supervisory functions.
- AG 2. In some jurisdictions, governance systems consist of two tiers, where supervision and management are separated or where local law provides for a supervisory body drawn from non-executives to oversee an executive management body. In such cases, both tiers are to be covered in the disclosure of the undertaking's governance structure.
- AG 3. The undertaking is expected to disclose the information required about its governance structure in consideration of the information requested by [Draft] ESRS 2, with specific regard to sustainability matters, avoiding duplication and ensuring consistency between the disclosures.
- AG 4. The disclosure shall also include a concise description of the committees of the administrative, management and supervisory bodies, including the roles and responsibilities of each committee and their working procedures. This includes the frequency of their meetings and the main communication lines between the administrative, supervisory and management bodies and their respective committees.
- AG 5. The disclosure shall address all elements specified in paragraph 14 taking into consideration the following:
- (a) 'Independence' refers to conditions that enable the members of the governance body to exercise independent judgment free from any external influence or conflicts of interest. Independence generally means the exercise of objective, unfettered judgement. When used as the measure by which to judge the appearance of independence, or to categorise a non-executive member of the administrative, management and supervisory bodies or their committees as independent, it means the absence of an interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making.
  - (b) Significant positions can include cross-board memberships, or other position or commitment that requires time and attention able to compromise the member's ability to perform its duties in the organization.
  - (c) 'Competencies' includes those with respect to corporate reporting and audit.
- AG 6. The undertaking may describe the composition of the administrative, management and supervisory bodies and its committees by additional indicators of diversity, such as ancestry and ethnic origin, citizenship, creed, disability, or any other indicators of diversity that are relevant for reporting.

- AG 7. The undertaking may clarify if the chair of the administrative, management and supervisory bodies is also a senior executive in the undertaking, their function within the undertaking's management. This includes the reasons for this arrangement and how conflicts of interest are prevented and mitigated.
- AG 8. The elements of the disclosure shall allow identifying under-represented social and other groups.
- AG 9. The information on changes to the composition of the administrative, management and supervisory bodies of the undertaking from the previous reporting period should extend to the date of the sustainability report.
- AG 10. Information about the owners of the undertaking will be provided under ESRS G2 Disclosure Requirement 8 Beneficial ownership.

### ***Policies, targets, action plans and resources***

#### ***Disclosure Requirement G1-2 – Corporate governance code or policy***

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- AG 11. Art. 20 a) and b) of the Accounting Directive already require listed companies to disclose information about the Corporate Governance policy and code. To avoid duplication of information, if the undertaking already discloses the above-mentioned information in other sections of its management reports, it may incorporate it in its sustainability report by reference to that information, including any appropriate explanations, provided that such disclosures do constitute a separate element of information clearly identified in the other section of the management report as addressing this Disclosure Requirement.

#### ***Disclosure Requirement G1-3 – Nomination process***

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- AG 12. The description of the criteria used for the nomination and selection of members shall be made with reference to the undertaking's diversity policy (see below ESRS G1 Disclosure Requirement 4) and the relevant targets set to implement and align with that policy.

#### ***Disclosure Requirement G1-4 – Diversity policy***

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- AG 13. Art. 20 g) of the Accounting Directive already require listed companies to disclose information about the Governance diversity policy. To avoid duplication of information, if the undertaking already discloses the above-mentioned information in its management report, it may include it in its sustainability statements by reference, including any appropriate explanations, provided that such disclosures do constitute a separate element of information clearly identified in the other section of the management report as addressing this Disclosure Requirement.

#### ***Disclosure Requirement G1-6 – Remuneration policy***

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- AG 14. The disclosure shall address all elements specified in paragraph 32 taking into consideration the following:
- (a) Fixed pay and variable pay
    - i. This may include performance-based pay, equity-based pay, bonuses, as well as deferred and vested shares;

- ii. If the undertaking uses performance-based pay, it should describe how remuneration for senior executives is designed to reward long-term performance.

(b) Termination payments

- iii. This includes all payments and benefits given to a departing member of the administrative, management and supervisory bodies or senior executive whose appointment is terminated;
- iv. It also extends beyond monetary payments and includes the transfer of property as well as the automatic or accelerated vesting of incentives;
- v. If the undertaking provides termination payments, it should explain whether:
  - A. the notice periods and termination payments for members of its administrative, management and supervisory bodies and senior executives are different from those for other employees;
  - B. the departing members of its administrative, management and supervisory bodies and senior executives receive payments other than those related to the notice period;
  - C. any mitigating clauses are included in the termination arrangements.

(c) Clawbacks

This is the repayments of previously received compensation that a member of the administrative, management and supervisory bodies or senior executive is required to make to the undertaking if certain conditions of employment or goals are not met.

(d) Retirement benefits

The undertaking should report the differences between the retirement benefit schemes and the contribution rates for the members of its administrative, management and supervisory bodies, senior executives, and all other employees.

**Disclosure Requirement G1-7 – Risk management processes**

AG 15. ESRS 2 Disclosure Requirement IRO 1 Description of the processes to identify material sustainability strategies and performance in incentives schemes requires the undertaking to describe the processes to identify material sustainability impacts, risks and opportunities. The undertaking may provide the disclosure required in paragraph 34 in conjunction with the one requested by [Draft] ESRS 2.

AG 16. Under this Disclosure Requirement the undertaking shall provide a summarised description of:

- (a) the principal risks to which the undertaking is exposed due to its business model;
- (b) the strategies and processes to manage and mitigate risks that arise from the undertaking's business model;
- (c) how the administrative, management and supervisory bodies and senior management assess and manage risks;
- (d) the risk management responsibilities attributed through the undertaking's organisation and its departments. This includes the distinction of oversight and delegation of authority, as well as the breakdown of responsibilities by type of risk, and the business units involved;

- (e) the relationships between the structures involved in risk management, such as the administrative, management and supervisory bodies, executive management, separate risk committee and risk management structure;
- (f) process of risk information reporting provided to the administrative, management and supervisory bodies and senior management, in particular the scope and main content of reporting on risk measures.

AG 17. The undertaking may disclose the key risk indicators used to monitor its exposure to risks.

AG 18. The undertaking may provide a concise description of how it cultivates and promotes risk awareness culture throughout the organisation, such as weaving it into its normal processes and continuously improving its risk management practices.

AG 19. The disclosure shall include a description of the policies and procedures followed in this respect, the associated roles and responsibilities, the relevant training activities and other initiatives, and the commitment of the leadership to this effect. This shall include the channels to communicate, disseminate and enforce the risk culture within the undertaking (for example code of conduct, operational manuals containing limits or procedures to treat violations or breaches of risk thresholds, etc.).

AG 20. Art. 20 of the Accounting Directive already require for listed companies to disclose information about the Risk Management process. To avoid duplication of information, if the undertaking already discloses the above-mentioned information in the management report, it may include it in its sustainability statements by reference, including any appropriate explanations, provided that such disclosures do constitute a separate element of information clearly identified in the other section of the management report as addressing this Disclosure Requirement.

### ***Disclosure Requirement G1-8 – Internal control processes***

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AG 21. Under this Disclosure Requirement the undertaking shall provide a summarised description of:

- (a) internal control responsibilities attributed through the undertaking's organisation and its departments. This includes a distinction between the oversight and delegation of authority and includes a breakdown of responsibilities by type of control, and the business units involved;
- (b) relationships between the structures involved in internal control processes, such as administrative, management and supervisory bodies, executive management, compliance function, and internal audit function.

AG 22. Undertakings may disclose whether the administrative, management and supervisory bodies reviews the adequacy of the undertaking's internal controls to strengthen the integrity and credibility of the undertaking's sustainability statements.

### ***Performance measurement***

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

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AG 23. Under this Disclosure Requirement the undertaking shall provide a description of the composition of the administrative, management and supervisory bodies in terms of age, gender and other categories of diversity.

AG 24. When compiling the information required in paragraph 43, the undertaking should refer to the same bodies as identified in paragraph 14.

AG 25. With reference to the administrative, management and supervisory bodies the undertaking shall calculate:

- (c) the percentage of women and men over the total members of each body and as an average ratio of female to male board members;
- (d) the percentage of body members that relies to each age group, as identified in other disclosures already provided in the sustainability statements;
- (e) specific indicators of diversity, such as ancestry and ethnic origin, citizenship, creed, disability, or any other indicators of diversity that are relevant for reporting.

AG 26. The disclosure shall include information on changes to the composition of the administrative, management and supervisory bodies of the undertaking from the previous reporting period, including with respect to diversity, with the associated reasons.



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