

GUIDELINE

# How to prepare the IFS ESG Compliance Check



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# INTRODUCTION

The performance of an organisation is increasingly assessed not only according to financial criteria but also based on its commitment to improve the sustainability circumstances linked to the products or services provided. International guidelines and upcoming legislation set expectations for responsible business conduct and due diligence, ESG (economic, social and corporate governance) and non-financial reporting. At the same time, there has been a rise in consumer awareness along with the tangible impact of climate change, the call for transparency and the result of initiatives such as the United Nations Sustainable Development Goals and the targets set by the Paris Agreement.

Sustainability and human rights impacts are entering the domains of corporate risk management and compliance, tightening up sourcing requirements. On top of that, many companies are looking beyond compliance to create lasting positive impact for their stakeholders including society and to stand out from their competitors.

Looking at this from another perspective, there is also a risk of greenwashing, this is when companies make themselves or their products appear more sustainable than they really are. For example, when companies communicate highly aspirational objectives that are not achievable. With sustainability gaining societal and business interest, it is becoming even more important to prevent these types of bad practices by building knowledge and the right competences within organisations.

To help companies address the growing demand for transparency and trust, and to assist them in succeeding on their ESG journey, IFS has developed a straightforward program called the IFS ESG Compliance Check. It's a process check that evaluates a company's effectiveness in managing its sustainability practices and supply chain management systems.

This guideline is intended to help companies that want to undergo the IFS ESG Compliance Check. It explains the check's structure, context, and interpretation of its requirements. Additionally, it provides practical examples of potential evidence to ensure that companies are well-prepared for the check.

# APPROACH OF THE IFS ESG COMPLIANCE CHECK

The primary goal of the IFS ESG Compliance Check is to raise awareness about the risks associated with Environmental, Social, and Governance (ESG) factors in supply chains and to encourage companies to improve their management processes related to these factors. By providing validated data on these aspects, companies can safeguard their businesses and build trust with customers and other stakeholders. The check is a voluntary tool in which an auditor or assessor evaluates a company's pre-assessment and risk mitigation plan. The resulting report details the company's status and progress in its sustainability and supply chain management system.

The requirements of the IFS ESG Compliance Check linked to sustainability management system are geared to providing companies a consistent start in setting up a sustainability framework. For themselves, as well as for their customers and other stakeholders, this will give a solid insight into where they stand regarding implementation of sustainability, ESG and due diligence.

The IFS ESG Compliance Check is composed of the basic program and the IFS Carbon Footprint module to cover different areas of sustainability. More modules can be added in the future to provide solutions to the arising sustainability challenges that companies are facing.

The basis of the IFS ESG Compliance Check is a set of general requirements that focus on the implementation of the sustainability and the supply chain transparency management system in the company. This system covers own operations, the supply chain, its risks, and the mitigation of these risks.

The criteria of the IFS ESG Compliance Check can be assessed as an extra to annual IFS Certification Audits, other audits, or IFS Progress assessments and can be performed onsite or remotely. Companies that are not IFS certified can also benefit from this tool.

This graphic visualises the relationship between the IFS ESG Compliance Check and the IFS Carbon Footprint module.



## About this guideline:

This guideline contains basic expectations for implementing the requirements. The requirements for each section are explained under “What does it mean?” Additionally, expectations outline what the company should have in place as “Evidence” to demonstrate compliance and what the auditor will request during the IFS ESG Compliance Check.

A “shall” is considered as a clear expectation for compliance with the requirement. Non-compliance will result in a lower score for the specific requirement.

As the topic is new for most small and medium-sized enterprises (SMEs), practical guides are provided in the Annex to give guidance on the best practice approaches as to how the company can implement the requirements, such as developing a code of conduct for suppliers, mapping the supply chain, identifying risks, conducting a hazard analysis and risk assessment, setting up monitoring measures and conducting a risk assessment for claims. These practical guides are not mandatory but rather serve as support while implementing the requirements.

# 1



# 1. The importance of sustainability and supply chain management

## 1.1 What is the added value of a supply chain analysis?

### **Identify, assess and improve risk assessment**

When it comes to downstream business partners, customers increasingly expect to know how and where the products they purchase are sourced from and manufactured. Also, for the companies themselves, by mapping their supply chains, they can better understand the risks of adverse impacts within their own supply chains.

For example, some countries have higher rates of exploitative practices like modern slavery and are therefore a higher risk to source from. Knowing where suppliers are located helps to understand the magnitude of these risks.

### **Make informed business decisions and prevent risks by gathering data**

By gathering data about their supply chains, companies can prevent and mitigate risks, build long-term supplier partnerships, and support suppliers. In the digital age, data has become one of the most valuable assets to businesses. Let's take scope 3 greenhouse gas emissions as an example. They often represent between 80% to 95% of an organisation's corporate carbon footprint for manufacturing companies. That is why it is so important for companies to collect data from their supply chain.

### **Engage with more business partners**

Environment, social, and governance criteria (ESG) has become fundamental for retailers and other business partners. Incorporating supply chain mapping into a complete due diligence program is key to reassuring partners that companies understand their supply chains and have genuine visibility of the risks that exist within them.

Ultimately, transparency gives companies the ability to prepare for possible disruptions and react quickly when a situation or unexpected event occurs. This is true whether the disruption is a single event, a seasonal peak in sales, or a pandemic, war, etc. And, as a result, supply chain operators can respond to disruptions faster than ever before.



## 1.2 Implementation of a sustainability and supply chain transparency management system

The requirements of the IFS ESG Compliance Check are built up in alignment with European directives, international guidelines and good practices with regard to sustainability management systems and due diligence processes. A number of relevant sources are included in Annex 2. Important references are the OECD Guidelines for Multinational Enterprises, the United Nations Guiding Principles on Business and Human rights, and the GRI Sustainability Reporting Standards.

The main recurring elements in international guidelines and legislation regarding corporate sustainability reporting and due diligence are summarised in the diagram below. These elements will be further explained and connected to the requirements in the IFS ESG Compliance. Examples of evidence are provided for each element to help support implementation of the requirements.



### 1.3 The importance of knowing the supply chain and how to gather information

Transparency in the supply chain is to know what is happening upstream in the supply chain and to communicate this knowledge both internally and externally. Supply chain transparency requires that a business understands exactly what is happening at every stage of its supply chain.

Supply chains can be very complex, comprising of many direct and indirect suppliers and regions where raw materials pose any form of sustainability risk, or simpler with local chains. Different cases may require a different amount of data to handle.

As an example:

A global canned tuna manufacturer located in Europe with more than 50+ direct suppliers in Southeast Asia and even more indirect suppliers dispersed across different regions, requires more extensive supply chain mapping than a meat producer located in Brazil with only a few local cattle farmers. Logically, when the number of suppliers is large, companies need to prioritise which adverse impacts of its products and/or suppliers require immediate action.

What kind of data is required and how much detail is necessary for the different cases mentioned above? That can vary depending on where the business is operating, the number of suppliers involved and the origin countries of the raw materials. And what level of disclosure can we expect? This depends on the corporate culture and corporate values of each company. Beyond that what is strictly required by regulation, if existing, supply chain transparency can mean different things to different companies. The impact of these different types of supply chain can have on the environment and on humans is undeniable. This makes it necessary to encourage companies to incorporate due diligence and transparency to minimise all negative impacts along the entire supply chain.

In Europe for example, a key issue is the enforcement of the Corporate Sustainability Due Diligence Directive (CSDDD), which aims to foster sustainable and responsible corporate behaviour while anchoring human rights and environmental considerations in companies' operations and corporate governance. These new directives ensure that companies are obliged to address adverse impacts of their actions, including in their value chains inside and outside Europe. Other regions of the world are following the same approaches.

# 2



## 2. Implementing the requirements of the IFS ESG Compliance Check

### List of the IFS ESG Compliance Check requirements

REQ NO	
<b>1</b>	<b>Sustainability and Supply Chain Transparency policy</b>
1.1	<p>The company shall develop, implement, and maintain a sustainability policy that includes, at a minimum:</p> <ul style="list-style-type: none"> <li>• A description of the company's approach to its environmental, social and governance principles.</li> <li>• A description of the company's approach on due diligence, also in the long term, including the relevant environmental, social, and governance principles.</li> <li>• Consideration of stakeholders (e.g. customers) concerns, if applicable.</li> <li>• A supply chain transparency policy, based on risk, of the supply chain partners involved in the production and distribution of the company's products.</li> <li>• A code of conduct (CoC) describing rules and principles to be followed internally and by the supply chain partners.</li> </ul>
1.2	The sustainability and/or the supply chain transparency policy shall be reviewed annually or upon changes.
<b>2</b>	<b>Senior management commitment</b>
2.1	The senior management shall be fully committed to the achievement of the sustainability and supply chain transparency policy across the company and shall provide sufficient and relevant resources to make it possible.
2.2	The senior management shall set up goals, related measures and deadlines for implementation of the sustainability and supply chain transparency policy.
2.3	For any deviation detected to established measures, the senior management shall implement appropriate corrective actions. In case of adverse impacts caused by the company, the senior management shall provide remediation.
2.4	The sustainability and supply chain transparency policy and framework shall be communicated to the employees and shall be broken down into specific goals and targets for the relevant departments.
2.5	The senior management shall ensure that a notification mechanism and complaint management is set up for the own business area and for the supply chain, that enables all stakeholders to report human rights and environment related risks and adverse impacts.
<b>3</b>	<b>Sustainability policy framework</b>
3.1	<b>Responsible team / Sustainability team leader</b>
3.1.1	There shall be a responsible team / sustainability team leader for the development and maintenance of the sustainability and supply chain transparency policy. Those responsible for the development and maintenance of the policy shall have received adequate training in the application of the ESG principles/ sustainability topics. Where competent knowledge is not available, external expertise shall be obtained.
3.1.2	The responsible team / sustainability team leader shall carry out a stakeholder analysis to identify direct and indirect affected interested parties. This shall be reviewed at least annually and/or upon changes.

3.2	<b>Risk identification</b>
3.2.1	The company shall document, implement and maintain a procedure for risk identification with regard to its own operations and the supply chain, which shall include as a minimum human rights and environment related risks.
3.2.2	The company shall identify and document risks for its own operations and in the supply chain with regard to human rights, business ethics and environmental impact. Based on this, critical raw materials shall be identified and documented in the risk mitigation plan.
3.2.3	Based on risk, the company shall have a current overview of the supply chain partners involved in the production and distribution of their products. This shall be reviewed at least annually and/or upon changes.
3.2.4	The company shall monitor on a continuous basis the compliance of supply chain partners with applicable legislation, the code of conduct (CoC) and customer requirements. The frequency of monitoring shall be risk based.
4	<b>Assessment of adverse impacts and mitigation</b>
4.1	The responsible team/ sustainability team leader shall carry out a risk analysis to identify and prioritise (potential) adverse impacts that are most critical under consideration of the double materiality approach. This analysis shall be reviewed annually or upon changes.
4.2	The responsible team/sustainability team leader shall make sure that measures to prevent, neutralise and /or mitigate adverse impacts are planned and executed by the relevant departments.
4.3	A risk based mitigation plan shall be established to effectively minimise (potential) adverse impacts in connection to products and their raw materials. This plan shall be documented in the risk mitigation plan and shall be reviewed annually and/or upon changes.
4.4	The responsible team / sustainability team leader shall fill in the risk mitigation plan, using the pre-defined list of critical raw materials, as applicable.
5	<b>Stakeholder communication and data management</b>
5.1	The company shall document, implement and maintain a procedure for stakeholder management and engagement. The procedure shall ensure that stakeholders are effectively engaged in the due diligence processes. When required by the customer, the company shall update its customers about the progress made on identified goals.
5.2	The company shall communicate its supplier code of conduct (CoC) to all supply chain partners and ensure confirmation.
5.3	Based on risk, the company shall implement effective data management regarding supply chain transparency.

## 2.1 Sustainability and supply chain transparency policy

1	Sustainability and Supply Chain Transparency policy
1.1	<p>The company shall develop, implement, and maintain a sustainability policy that includes, at a minimum:</p> <ul style="list-style-type: none"><li>• A description of the company's approach to its environmental, social and governance principles.</li><li>• A description of the company's approach on due diligence, also in the long term, including the relevant environmental, social, and governance principles.</li><li>• Consideration of stakeholders (e.g. customers) concerns, if applicable.</li><li>• A supply chain transparency policy, based on risk, of the supply chain partners involved in the production and distribution of the company's products.</li><li>• A code of conduct (CoC) describing rules and principles to be followed internally and by the supply chain partners.</li></ul>
1.2	<p>The sustainability and/or the supply chain transparency policy shall be reviewed annually or upon changes.</p>

### What does it mean?

- The sustainability policy is setting the fundamental basis for the long-term development of the company's due diligence. The sub-areas encompassing environmental, social/human rights, and ethical business conduct related to the company's own activities and its supply chain.
- It is important that the policy outlines long term due diligence efforts and covers all activities and stakeholders of the organisation, as well as the organisation itself. The supply chain transparency policy can be part of the overall ESG/sustainability policies of the company, or set up as own policy element. It shall include upstream transparency aspects regarding all finished/semi-finished products and its raw and packaging materials as well as services offered by the organisation.
- A policy is not only a written statement from the senior management and thus shall be developed in prior consultation with the company's employees and their representatives, in compliance with CSDDD, Art. 7.
- As part of the policy, a code of conduct (CoC) shall be developed, to inform and agree within the company and with the partners in the supply chain about rules and principles to be followed. About how a company can develop their own code of conduct please check the Annex 2.
- The policy and code of conduct shall consider and reflect the UN Guiding principles on business and human rights (UNGP) and the OECD Guidelines for Multinational Enterprises (MNE Guidelines) to comply with Annex 1 of the directive (EU) 2024/1760 (CSDDD).
- There are international environmental and labour standards that have set the standard for many supplier codes of conduct, based on the former mentioned guidelines. A company may choose to use these standards as a basis for their own supplier code of conduct (CoC) to ensure that their suppliers adhere to these specific standards. By creating a supplier code of conduct, the company sets clear expectations for suppliers using an approach they can consult and engage with. The CoC is especially relevant if the company sources materials and products from countries where environmental and labour laws are either lacking or underenforced.
- The policy shall be reviewed and updated at a minimum annually. Reviews are to be informed by the outcomes of the annual materiality and risk assessments as well as monitoring activities and results from the notification mechanism and complaint procedure.

- Changes to the policy and/or code of conduct during the year may be needed due to deviations in their implementation. For example, adjustments might be required if certain actions did not achieve the desired outcome. The policy and its CoC are considered as the fundamental basis for part of the continuous improvement process, closely linked to the risk management / due diligence cycle.

## Evidence

- Written policy statement(s), which shall be easily and freely accessible via the internet.
- Records of communication of the policy statement to employees, e.g. as part of a newsletter, intranet, as part of the onboarding of new employees. The policy should be readily available for employees in multiple languages.
- Code of conduct for internal organisation, with records of communication to employees and available in multiple languages.
- Code of conduct for business partners/suppliers, with records of how the CoC is integrated into the agreements and tendering processes with suppliers (e.g. examples of supplier contracts or written commitments by suppliers to the CoC).
- Supplier requirements/sourcing conditions can also be reviewed as evidence of the communication of the policy to suppliers if no code of conduct has yet been set up.
- Updates/versions of the policy in the past years.
- Documents with information on the goals and KPI's set within the organisation related to the policy, e.g. strategy documents, performance updates/reports.



## 2.2 Governance and management

<b>2</b>	<b>Senior management commitment</b>
2.1	The senior management shall be fully committed to the achievement of the sustainability and supply chain transparency policy across the company and shall provide sufficient and relevant resources to make it possible.
2.2	The senior management shall set up goals, related measures and deadlines for implementation of the sustainability and supply chain transparency policy.
2.3	For any deviation detected to established measures, the senior management shall implement appropriate corrective actions. In case of adverse impacts caused by the company, the senior management shall provide remediation.
2.4	The sustainability and supply chain transparency policy and framework shall be communicated to the employees and shall be broken down into specific goals and targets for the relevant departments.
2.5	The senior management shall ensure that a notification mechanism and complaint management is set up for the own business area and for the supply chain, that enables all stakeholders to report human rights and environment related risks and adverse impacts.
<b>3</b>	<b>Sustainability policy framework</b>
3.1	Responsible team / Sustainability team leader
3.1.1	There shall be a responsible team / sustainability team leader for the development and maintenance of the sustainability and supply chain transparency policy. Those responsible for the development and maintenance of the policy shall have received adequate training in the application of the ESG principles/ sustainability topics. Where competent knowledge is not available, external expertise shall be obtained.
3.1.2	The responsible team / sustainability team leader shall carry out a stakeholder analysis to identify direct and indirect affected interested parties. This shall be reviewed at least annually and/or upon changes.

### What does it mean?

- For effective implementation of a sustainability management system and the sustainability policy, a clear assignment of governance has to be in place. This relates to how the management of the impact on economy, environment and people is integrated into the organisation's strategy and operations. Good governance is the essential basis for an effective sustainability management system.
- One of the main prerequisites for a strong governance is that the final responsibility to achieve the objectives and goals are allocated at senior management level. A lack of direct senior management involvement is widely regarded as an indicator that a company is not truly committed to act on due diligence matters.
- Senior management sets out the goals and makes sure sufficient resources are allocated to the implementation of measures according to defined deadlines.
- Corrective actions have to be taken in case of detected deviations. This includes any deviation resulting from monitoring activities, the notification mechanism and complaint procedure or any other source in connection to due diligence matters. This also applies to remediation measures that the senior management shall establish for adverse effects, caused directly or jointly by the company, in compliance with Art. 12 of the CSDDD. Corrective and remediation measures shall be effective.
- Senior management has to be fully committed to the sustainability management system. The effectiveness



of the sustainability policy can be substantially increased when non-financial metrics and targets relating to the sustainability policy are included in the compensation system of senior management. Thereby the company demonstrates the importance it adheres to responsible business conduct to its employees and external stakeholders.

- Roles and responsibilities within the organisation regarding the implementation of the sustainability policy shall be clearly defined. This can either be done in the form of specific sustainability functions in the organisation or integrated in existing roles and organisational functions such as HR, operations, marketing/communication and procurement/sourcing. In smaller companies it is likely that the organisation starts either by appointing one lead person from an already existing role, for instance the quality manager, or to create a sustainability team, that combine the tasks with their existing functions.
- The sustainability team or the team responsible for ESG matters should perform a stakeholder analysis. This shall involve:
  1. **Identifying Stakeholders:** Mapping out all individuals, groups, and organisations that may be directly or indirectly impacted by the company's sustainability efforts. This can include employees, customers, suppliers, regulatory bodies, local communities, investors, NGOs, and even competitors.
  2. **Assessing Impact:** Determining how these stakeholders are affected by the company's operations, policies, and sustainability initiatives. "Direct" stakeholders would be those immediately impacted (e.g., employees, customers), while "indirect" ones might include communities or environmental groups affected by broader supply chain practices.
- Employees have to be trained in the sustainability policy and what it means for their work, at a minimum those employees that are actively involved in the implementation of measures.
- There has to be a clear reporting relationship from the sustainability team/or lead to the senior management that has the end responsibility for the sustainability management system.
- To be able to act upon any adverse impacts within its own operations or the company's supply chain, the company needs to establish and maintain a notification mechanism and complaint procedure in accordance with Art. 14 of the CSDDD, to ensure that issues can be brought to the company's attention and can be further dealt with. This procedure shall be fair, publicly available, accessible, confidential and predictable. It shall be ensured that complainants are informed about the outcome and measures taken.

*Example on a multi-channel approach for a notification mechanism for an assessed company:*

Notification Channels:

1. **Online Portal:** the assessed company has set up an online platform where any stakeholder can submit a notification about issues related to environmental pollution, unfair labour practices, or product safety concerns. The form is available in multiple languages and ensures confidentiality.
2. **Phone Line:** The assessed company operates a dedicated hotline available 24/7 for employees, suppliers, and local communities to report concerns. The line is managed by an independent third party to guarantee impartiality.
3. **In-Person Reporting:** On-site at all major facilities, there are designated offices where workers and community members can submit notifications. Trained personnel are available to guide individuals through the process.
4. **Email Reporting:** Stakeholders can also send notifications via a dedicated email address: `notify@company-name.com`. Emails are encrypted to protect confidentiality.

## Evidence

- Agendas and minutes of management reviews.
- Stakeholder analysis, identifying stakeholders and assessing impact.
- Department/team goals and KPI's and records of review of progress, e.g. as part of team meetings or internal management reports.
- Job profiles and goals/targets of employees (including senior management) involved in the implementation of the sustainability policy, job appraisals.
- Attendance records of sustainability related training, training materials for different roles/departments.
- Documented notification mechanism and complaint procedure information about the notification mechanism and complaint procedure, which shall be easily and anonymously accessible to all stakeholders, including workers and communities in the supply chain of an organisation. It is part of the interaction with stakeholders, and it provides information on possible violation of stakeholders' interests, so that the organisation can act on it. Complaints also provide useful input for the recurring risk assessment and to align or improve mitigation strategies.



## 2.3 Supply chain analysis, risk identification and monitoring

3.2	Risk identification
3.2.1	The company shall document, implement and maintain a procedure for risk identification with regard to its own operations and the supply chain, which shall include as a minimum human rights and environment related risks.
3.2.2	The company shall identify and document risks for its own operations and in the supply chain with regard to human rights, business ethics and environmental impact. Based on this, critical raw materials shall be identified and documented in the risk mitigation plan.
3.2.3	Based on risk, the company shall have a current overview of the supply chain partners involved in the production and distribution of their products. This shall be reviewed at least annually and/or upon changes.
3.2.4	The company shall monitor on a continuous basis the compliance of supply chain partners with applicable legislation, the code of conduct (CoC) and customer requirements. The frequency of monitoring shall be risk based.

A supply chain analysis is the crucial base for its transparency and following risk management. For complete transparency, each point of the supply chain shall be included, from raw material extraction or harvesting and transport of goods, to final products or services provided to customers.

According to Alexis Bateman, research scientist and head of MIT Sustainable Supply Chains at the MIT Center for Transportation and Logistics, there are two critical components to supply chain transparency:

- Visibility: identifying and collecting data from all links in the supply chain.
- Disclosure: communicating such information, both internally and externally, at the level of detail required or desired.

After a comprehensive analysis of the supply chain, it is necessary to identify the riskiest points and to establish a monitoring procedure in order to control these risks.

### What does it mean?

- According to the OECD Guidelines, “risk” refers to the likelihood of (potential) adverse impacts on people, the environment and society that are caused by, contributed to, or directly linked to enterprises. In other words, it is an outward-facing approach to risk. Due diligence helps companies anticipate and prevent or mitigate these impacts.
- The type of risks that are to be expected along the supply chain, but are not limited to, include social and environmental risks such as the availability of natural resources, pollution, climate change, water scarcity or marine resources, labour and human rights, workers in the value chain, child labour, rights of local communities, business ethics, etc. By identifying the risks, companies shall determine the applicable category by clustering each identified risk to one of the topical ESRs.
- Procurement departments have struggled with supplier risk management for years since these risks can severely limit operations. Failure to assess these supplier risks prior to entering into an agreement with a new supplier, or failure to continuously monitor their risk profile throughout the partnership can lead to surprises that have a substantial impact on the stability of the supply chain, and hence the operations.

- In some cases, supplier risk may not be able to be totally eliminated. This emphasises the need to take the required actions to control it. It is critical to conduct due diligence, assessing the risk of any key suppliers to establish whether they pose a threat to the operation, how easily they can be replaced, if necessary, as the last resort, and how much it would cost if something went wrong.
- Ensure feedback from supply chain mapping and monitoring and from the notification mechanism and complaint management into the risk assessment process – ref. to due diligence cycle to identify sustainability risks.
- After risk identification it is necessary to establish a general and reliable monitoring system, which enables the company of being informed about non-compliance of suppliers to legal requirements and breaches to the company's code of conduct as well as relevant customer requirements.
- For monitoring purposes in regard to stakeholder requirements and for corporate reporting purposes, the company may also need to collect evidence and quantitative information (such as GHG emissions data) from the production locations that show compliance to requirements that are set by law, guidelines or client requirements (ref. to supplier requirements, codes of conduct). To determine the effectiveness of actions with regard to the risk management, certain data has to be collected. Examples can be: supplier audits, certifications, human rights and environmental impact assessments, quantitative data/metrics, sector collaborations, etc.

For more details on how a risk identification can be carried out and the necessary steps to be taken, please refer to the IFS Supply Chain Processes Check Guideline.

#### *Risk identification using the example of the Italian processed tomato supply chain:*

Risk profiling suppliers is an important step for the company. By doing this, companies can then work towards implementing mitigation steps to minimise the cost of non-compliance, if something goes wrong. Following the risk profile, companies will know which supplier(s) bring the highest risk to their business and are of the highest cost.

Once they are identified, companies will know how much time and resources they need to dedicate to monitor them. These suppliers should be at the top of the priority list whenever companies carry out audits to ensure that they are on track. And whenever any supplier information is updated – they should be first on the list, so that all insurances or required certifications permitting the supplier to carry out work are up to date.

Issue management is required when a company detects a risk in their supply chain.

Let's take the Italian processed tomato supply chain as an example to illustrate issue management:

It is well known that migrant workers are employed to do the tomato harvest by handpicking. One of the main identified problems is related to human rights with particular focus on (undocumented) migrant workers.

- To fully understand the human rights issues in their canned tomato supply chain, retailers and brand manufacturers need to have insight into the different actors in their supply chains beyond their direct suppliers up until the level of the Italian farmers.
- Transparency at farm level is crucial to enable informed decision making by the company itself, but also for retailers and brands to work with their suppliers on improving human rights issues in the supply chain.
- For example: if a customer is willing to pay more to their contract supplier, how can the customer be sure that the farmer receives the fair share of this premium? And that the farmer truly pays this premium to

the workers in a legal way? Retailers and brand manufacturers can only perform checks on the effective distribution of a premium towards farmers or workers when they have transparency data up until the level of the farmers that are linked to their supply chain. The processed tomato supply chain starting from the retailer and/or brand manufacturer to the actual Italian farmer, where most of the major issues take place, can be complex and take a lot of time to put together.

In this example, we can see how the power of positive influence by retailers and buyers, as well as transparency along the chain, is crucial.

## Evidence

- Matrix assessment, software/applications, etc.
- Supplier assessment, risk profiles, audits, etc.
- Risk identification procedure
- Notification mechanism and complaint management feedback.
- Records of systematic supplier/supply chain monitoring of client requirements related to the sustainability policy and risk assessment, to measure compliance and progress towards set goals and to be alerted of possible incidents and violations of stakeholders' rights. This can include mapping (part) of the supply chain per product or product group, collecting third-party audit reports and certificates, collecting quantitative data, e.g. on GHG emissions or water use, or living wages.

Checks: Has the content of the audit reports been analysed to gather insights into the actual status of the ESG impacts? Do certificate standards sufficiently cover the identified risks of the specific product group?



## 2.4 Assessment of adverse impacts and mitigation strategies

4	Assessment of adverse impacts and mitigation
4.1	The responsible team/ sustainability team leader shall carry out a risk analysis to identify and prioritise (potential) adverse impacts that are most critical under consideration of the double materiality approach. This analysis shall be reviewed annually or upon changes.
4.2	The responsible team/sustainability team leader shall make sure that measures to prevent, neutralise and /or mitigate adverse impacts are planned and executed by the relevant departments.
4.3	A risk based mitigation plan shall be established to effectively minimise (potential) adverse impacts in connection to products and their raw materials. This plan shall be documented in the risk mitigation plan and shall be reviewed annually and/or upon changes.
4.4	The responsible team / sustainability team leader shall fill in the risk mitigation plan, using the pre-defined list of critical raw materials, as applicable.

### 2.4.1 Adverse impact assessment

#### What does it mean?

- In the context of corporate ESG and CSRD reporting, and based on the risk identification, the company shall conduct a double materiality assessment. In this context, the impact and financial materiality have to be assessed.
- The term “impact materiality assessment” is used to indicate the process of an organisation determining its main (material) actual and potential adverse impacts on economy, environment and people from an inside-out perspective. Impacts are related to the nature of the company’s activities and products, its supply chain and other business relationships. The measures that a company takes to fulfil due diligence shall be commensurate to the severity and of the adverse impact.
- The impact assessment is resulting in a risk score on the significance of the individual impact.
- “Financial” materiality on the other hand, focuses on how sustainability issues impact the company’s financial performance and future viability from an outside-in perspective. This perspective includes beyond risks also opportunities.
- To ensure a proper implementation of this approach, please refer to EFRAGs guidance on the double materiality assessment: [https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets/IG%201%20Materiality%20Assessment\\_final.pdf](https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets/IG%201%20Materiality%20Assessment_final.pdf)
- The double materiality assessment is to be performed in consultation with representatives of the identified stakeholders. The result of the assessment is a list of “material” topics that inform about the company’s strategy and priorities. Knowledge about its main impacts shall be the basis of the company’s sustainability policy and the code of conduct (CoC).
- Prior to or as to start of the double materiality assessment, it is necessary for the company to identify its stakeholders and make sure they are involved in the process. For this, the concept of stakeholder analysis is often used, to enable a comprehensive identification all relevant stakeholder groups.
- In the context of CSRD and CSDDD, the assessment of impacts focuses on (potential) adverse impacts in relation to ESG topics. This is often referred to as a risk analysis, risk being defined as a certain likelihood of potential adverse impact on people, the environment, or animals. Part of potential adverse impacts of a company are usually linked to their own operations and business area, for example bad living conditions for migrant workers that are employed in one of the distribution centres. However, especially for companies that produce or sell tangible goods, an important part of (potential) adverse impacts are also linked to the company’s suppliers and their supply chains.
- For example, deforestation connected to the production of soy, coffee or other commodities, or pollution of local water sources by wastewater from a processing plant. Or severe health problems of workers that apply pesticides to the fields. Due diligence frameworks include a risk analysis process. The risk analysis helps to identify (potential) adverse impacts and to set priorities for the business strategy to prevent, mitigate and remediate those impacts.
- The risk analysis on (potential) adverse impacts shall consider the following two dimensions: probability of occurrence (likelihood) and the level of potential damage (severity). These two dimensions can be determined both qualitatively and/or quantitatively. Quantitative techniques can be based on statistical evaluations of the past or can be carried out with the help of simulation models.
- The assessment of the probability of occurrence (likelihood) and the level of potential damage (severity) shall result in a certain level of significance (i.e. risk score) as a basis for determining relevant mitigation measures.

- The identification and assessment of (potential) adverse impacts has to be repeated regularly, in principle once a year or when aspects of the business change, such as adding a new product to the assortment or when considering other sourcing countries for a raw material.
- The process and outcomes of identification and assessment of (potential) adverse impacts are disclosed and shared with stakeholders. Rationale has to be provided on why certain ESG issues or risks are either or not considered as material.

**A practical guide on steps and best practices on how to conduct a risk analysis can be found in Annex 3.**

## Evidence

- Information on the process of identification and assessment of (potential) adverse impacts by the company and the financial materiality assessment, the stakeholders involved and the outcomes. Examples: information on the corporate website, corporate newsletters or social media, information in the (annual) due diligence, sustainability report.
- Internal records on the procedures and processes related to the identification and assessment of (potential) adverse impacts. How are stakeholders identified, are their interests taken into account during the assessment; what methodology is followed to assess the risks and impacts and to rank and prioritise these for measures and action; are all relevant sources of information taken into account such as the complaint system and supplier monitoring?
- A documented risk analysis that reflects the motivation of the prioritisation of the risk profile. For example, why is a specific sourcing country identified as high risk on human rights? What is the source of this information? Are supply chain risks clearly mapped to where they can occur in the respective product or raw material supply chain?
- An up-to-date overview of all direct suppliers and transparent supply chain data available from high-risk suppliers (see also next paragraph on tracking risk mitigation).
- Notes, minutes or recordings of internal and/or external stakeholder sessions organised as part of the process of identification and assessment of risks and impacts.

### 2.4.2 Mitigation strategies and continuous improvement

#### What does it mean?

- Based on the risk score of each analysed (potential) adverse impact, the company shall develop an effective risk mitigation plan which targets the identified (potential) adverse impacts. This risk mitigation plan needs to be related to the company's own operations as well as to the up- and down- stream supply chain of the company.
- The measures and actions that are part of this risk mitigation plan are either of preventive nature, or are responsive and corrective, to neutralise or minimise already existing adverse impacts. The aim is to bring actual adverse impacts to an end (as requested in Art.11 of the CSDDD) or minimise the risk of potential adverse impacts, as per Art.10 of the CSDDD).
- Preventive actions are for instance the training of buyers, and setting up monitoring mechanisms for suppliers by using second or third party social compliance auditing standards.
- Examples of corrective (minimising or neutralising) actions are: start improvement programs with suppliers, reduce food waste or energy use within own operations, increase influence in specific sectors by joining up with other organisations in industry covenants, or offer remediation in cases such as

instance harassment, child labour or pollution of water used by local communities. Calculating and reducing the carbon footprint of an organisation (and its supply chain) is also part of the risk mitigation plan.

- By defining relevant measures, the company shall consider the risk score identified and apply relevant measures, to reach a maximum on possible mitigation. Companies are obliged to insert all relevant information into the IFS risk mitigation plan, including the risk nature as classified within the risk identification, as risk description, the individual risk score resulting from the analysis as well as the mitigation measures defined and applied to mitigate the (potential) adverse impact.
- By establishing the mitigation measures, the company shall rate these mitigation measures on a qualitative basis which will then result in a mitigation score. Derived from it, a number/score of residual risk may remain. If the number of residual risk is 1 or higher, the company needs to explain the nature of residual risk in the IFS risk mitigation plan.
- A practical guide on steps and best practices on how to establish mitigation measures and calculate mitigation score and residual risk, please refer to Annex 1 and 3.
- For many companies that produce or sell tangible goods, a major part of their due diligence and hence of their mitigation strategy will be focused on their supply chain. As a starting point for supply chain due diligence, a company has to know their direct suppliers and how these mitigate potential adverse impacts connected to the products that they supply to the company. If the risks identified are positioned deeper in the supply chain, for instance at the level of raw material production, it will be necessary to create, together with the direct supplier, further supply chain transparency to implement measures in indirect suppliers. The level of supply chain transparency required to map and mitigate the actual impacts related to specific products and their raw materials or components, has to be clearly explained as part of the assessment of adverse impacts and the mitigation strategy.
- As specified by Art 15, CSDDD, the effectiveness of the mitigation strategy has to be monitored by tracking actions and their results with regard to the identified issues and risks. This will not only provide feedback for the recurring risk analysis; it will also enable senior management to measure progress against set goals, KPI's and metrics and to report this to stakeholders.
- Tracking progress and results also has to be implemented for strategies relating to suppliers and their supply chains. This means that the direct suppliers and – where needed for monitoring identified risks – also indirect suppliers have to be known to the company, and relevant evidence on risk mitigation evidence is collected on a continuous basis.
- A sustainability or due diligence management system is in essence a cyclical process that works towards continuous improvement. In practice this means that actions that are taken to mitigate or prevent risks shall result in an adjusted risk assessment for the next period. If mitigation actions are not implemented as planned or do not have the desired results, the (root) causes shall be investigated and the organisation shall carry out the necessary corrective actions to attain improvement.

## Evidence

- Filled IFS risk mitigation plan, including relevant scores and measures as well as description of residual risks, if applicable.
- Records of action plans and specific measures that are implemented as a follow-up to risk analysis, including: what does the action entail and what (potential) adverse impact (and it's ESRS category) does it relate to, who is responsible, KPI's to monitor progress of implementation for the relevant teams and persons.
- Internal reports to senior management on progress and KPI's on the actions and measures.



- Complaint procedure(s) and whether these are publicly available.
- Checks: does the scope of the procedure include external stakeholders and supply chain, is confidentiality ensured, are reports of incidents fed back into the risk analysis.
- Records of complaints and concerns received via the complaint system.

### 2.4.3 Risk mitigation plan

The risk mitigation plan provides a risk analysis and a mitigation plan for all critical raw materials across different vulnerable areas in the supply chain. It includes the following information:

- **Raw materials:** List of critical raw materials used.
- **Country of origin of the raw material:** List the country of origin for each listed raw material.
- **Province:** For a more detailed location, list the province of the country.
- **Risk categories:** A list of the topics, sub-topics and sub-sub topics of the different risk categories.
- **Risk score:** A score given from the supplier evaluating the risk for the specific entry. Lowest number is one (1) and highest number which reflects a high risk is five (5).
- **Description:** The supplier has a free text option to describe the nature of the risk.
- **Mitigation score:** A score given from the supplier evaluating the mitigation plan for the specific entry. Lowest number is one (1) and highest number which reflects a very good mitigation plan is five (5).
- **Residual risk:** This is a number calculated automatically from the IFS auditXpress Neo Software gives the supplier a general overall picture of the final risk after the mitigation plan is entered. The number can be from zero (0), which reflects no risk at all to five (5) which is the maximum risk remaining.
- **Auditor comment:** The auditor can add a comment in the IFS auditXpress Neo Software regarding each raw material and the residual risk that they have.

This score enables the company to assess how effectively the mitigation plan addresses critical risks in the supply chain.

### What does it mean?

- The company shall identify critical raw materials in its supply chain and ensure they are documented in the risk mitigation plan. Critical raw materials are those that have a significant risk for adverse impacts regarding the product, its production or distribution.
- Even though the company identifies critical raw materials for all its products in its supply chain, it is not expected of them to enter data of the whole analysis in the risk mitigation plan. Only a selection of pre-defined critical raw materials must be documented in the IFS auditXpress Neo Software. This is however regardless of the outcome and severity level identified by the company as it is expected that these listed raw materials are anyway identified as critical.
- The company shall give details regarding the following: raw material, country of origin and identified risk factors. Explanation of further details can be entered via the "Explanation" field.
- The company shall give details regarding the risk mitigation plan that the company has set, if so, regarding each material. Explanation of further details can be entered via the "Explanation" field.

## Evidence

- Data saved in the IFS auditXpress Neo Software: updated and detailed risk mitigation plan that includes all critical raw materials identified.
- Ingredients and raw materials lists.
- Risk list which shows the process of identifying and classifying critical raw materials.
- Mitigation plan which shows the processes set by the company to control and minimise the risk of each raw material.
- Supply chain monitoring data: records showing ongoing monitoring of critical raw materials, including any adjustments made to the list.



## 2.5 Stakeholder involvement, communication and data management

### 2.5.1 Stakeholder involvement and communication

<b>1</b>	<b>Sustainability and Supply Chain Transparency policy</b>
1.1	<p>The company shall develop, implement, and maintain a sustainability policy that includes, at a minimum:</p> <ul style="list-style-type: none"> <li>• A description of the company's approach to its environmental, social and governance principles.</li> <li>• A description of the company's approach on due diligence, also in the long term, including the relevant environmental, social, and governance principles.</li> <li>• Consideration of stakeholders (e.g. customers) concerns, if applicable.</li> <li>• A supply chain transparency policy, based on risk, of the supply chain partners involved in the production and distribution of the company's products.</li> <li>• A code of conduct (CoC) describing rules and principles to be followed internally and by the supply chain partners.</li> </ul>
<b>2</b>	<b>Senior management commitment</b>
2.5	The senior management shall ensure that a notification mechanism and complaint management is set up for the own business area and for the supply chain, that enables all stakeholders to report human rights and environment related risks and adverse impacts.
<b>3</b>	<b>Sustainability policy framework</b>
3.2	Risk identification
3.2.1	The company shall document, implement and maintain a procedure for risk identification with regard to its own operations and the supply chain, which shall include as a minimum human rights and environment related risks.
<b>4</b>	<b>Assessment of adverse impacts and mitigation</b>
4.1	The responsible team/ sustainability team leader shall carry out a risk analysis to identify and prioritise (potential) adverse impacts that are most critical under consideration of the double materiality approach. This analysis shall be reviewed annually or upon changes.
<b>5</b>	<b>Stakeholder communication and data management</b>
5.1	The company shall document, implement and maintain a procedure for stakeholder management and engagement. The procedure shall ensure that stakeholders are effectively engaged in the due diligence processes. When required by the customer, the company shall update its customers about the progress made on identified goals.
5.2	The company shall communicate its supplier code of conduct (CoC) to all supply chain partners and ensure confirmation.
5.3	Based on risk, the company shall implement effective data management regarding supply chain transparency.

### What does it mean?

- Stakeholders have a central role in sustainability management and due diligence processes. Not only customers and investors are important as stakeholders, the interpretation of 'stakeholder' is within the context of sustainability much broader and also includes: employees and their representative bodies, suppliers and their workers in the supply chain and their families, local communities (think of water use or water pollution by nearby industries, or land grabbing practices), the local environment of a company's

operations and those of their suppliers and sub-suppliers (think of biodiversity loss by deforestation, soil degradation), and global environment (GHG emissions, climate change). The perspective and interests of all these potential stakeholders should be included throughout the sustainability and due diligence processes of an organisation: when defining the policy, when doing the risk analysis and defining the focus of the sustainability related efforts, when reporting on progress and results.

- Stakeholder communication is a very important element of the sustainability strategy, to demonstrate to stakeholders that what matters to them also matters to the organisation. This includes annual sustainability and due diligence reporting, but also informing stakeholders via public channels on a regular basis on objectives, goals and actions. Consumers can also be informed via the purchased products, for example via storytelling on the product packaging with information on where and how it was produced and how the brand contributes to the improvement of the circumstances for both people and the planet.
- Stakeholder involvement should be implemented as a central element into the sustainability management system, not only to gather information on (possible) adverse impacts, but also to consult with them for prioritising them and implementing appropriate measures to mitigate or neutralise (potential) adverse impacts. They should be also consulted for remediation issues, deciding for termination or suspension of business partners and developing or readjusting quantitative or qualitative monitoring measures, as requested in Art 13, CSDDD.

## Evidence

- Records on stakeholder identification (internal and external) and regular review.
- Annual communication plan as part of the sustainability/due diligence processes.
- Easy-to-find information on the company website on sustainability policy and the actions that are taken to achieve the goals and targets. Regular updates on progress. Concrete examples of improvements and positive impact for stakeholders in the supply chain.
- Storytelling on products.
- Publication or internal records of stakeholder identification for the sustainability strategy and due diligence process.
- Records and evidence for stakeholder involvement.
- Formal annual sustainability/ESG, due diligence or non-financial report.

### 2.5.2 Data Management and reporting

5	Stakeholder communication and data management
5.1	The company shall document, implement and maintain a procedure for stakeholder management and engagement. The procedure shall ensure that stakeholders are effectively engaged in the due diligence processes. When required by the customer, the company shall update its customers about the progress made on identified goals.
5.2	The company shall communicate its supplier code of conduct (CoC) to all supply chain partners and ensure confirmation.
5.3	Based on risk, the company shall implement effective data management regarding supply chain transparency.

## What does it mean?

- Data management in the framework of this program refers to the process of collecting, organising, securing storing and exchanging data on supply chain partners and origin of products, encompassing finished/semi-finished products, it's raw materials and packaging materials.
- The company shall implement a robust system for managing data within the supply chain to ensure transparency, particularly focusing on vertical systems (those that integrate processes across different levels, such as suppliers, manufacturers and distributors).
- This data can also be used to communicate and manage the code of conduct and seeking confirmation of the CoC by the supply chain partners, to ensure that the rules and principles are acknowledged and understood. To achieve this, the company shall develop convenient methods of communication with its business partners, in accordance with the data management and reporting strategies of the company.
- Data may be transferred through automated (electronic) or manual processes, and both methods must ensure accuracy, security, and reliability. It should also take into consideration the ability of supply chain partners.
- The system shall guarantee that data related to the supply chain (e.g. orders, inventory, product quality, compliance information of suppliers) is accurate, complete and accessible when needed, reducing errors and potential risks.
- To implement structural risk management in the supply chain, data management has to make sure the data is regularly updated and valid. Data quality and validation and verification procedures have to be set up, examples can be new supplier, inactivated production location, expired certification, etc.
- When required by the customer the company shall update its customers about the progress made on identified goals by appropriate means of communicating the progress. This could also be achieved by setting up a vertical data management system.
- Data has to be fed back into the due diligence process and ESG reporting, etc.

## Evidence

- Overviews, lists or database system(s) with supplier and supply chain data, origin of products, data on packaging materials.
- References to supply chain monitoring in stakeholder communication and Due Diligence & ESG reporting.
- Documentation on responsibilities, data quality and maintenance procedures.
- Software, if existing.

# 3



## 3 ANNEXES

### ANNEX 1 – Setting up a procedure for supply chain mapping and risk identification

#### How to start?

Gathering information is one of the most crucial and challenging aspects of mapping the supply chain but this should not discourage companies when it comes to starting out. This is an ongoing process, and it requires the collaboration of partners and the coordination of different functions.

In a simplified way, the procedure of mapping the supply chain shall involve the following steps:

#### 1. Define a policy and identify the scope

Determine the boundaries of the supply chain mapping exercise, if necessary. The company shall map the entire end-to-end supply chain, but first focus on specific segments or products, step by step focusing on the riskiest areas.

#### 2. Identify key players and collect information

Identify the actors in the supply chain, such as suppliers, manufacturers, distributors, retailers and customers. Make a list of all the parties involved in each step of the process and consult with them to gather necessary information on potential or actual adverse impacts, as requested by Art. 13, CSDDD.

#### 3. Visualise the supply chain

Create a visual representation of the supply chain using diagrams, flowcharts, or specialised software. There are many companies that offer this service. Start with a high-level overview and then break it down into specific steps, including sourcing, manufacturing, distribution and customer delivery.

#### 4. Identify dependencies

Identify the dependencies and relationships between different actors within the supply chain. Determine which suppliers are providing critical raw materials, which distribution centres serve specific regions, and which customers are most important for the business.

#### 5. Analyse risks

Identify potential generic risks and bottlenecks in the supply chain. Look for single points of vulnerability, such as products sourced from high-risk countries, relying on a single supplier, having limited transportation options or any other disruption. These risks need to be allocated to the topical ESRS as laid down in Annex 3.

#### 6. Evaluate performance

Measure and evaluate the performance of the supply chain. Use key performance indicators (KPI's) derived from the code of conduct and customer requests (if any) such as valid third-party certifications for environmental management systems or ethical sourcing standards or mandatory trainings for suppliers on anti-bribery and anti-corruption training of the supply chain.

## 7. Regularly update the map

Continuously monitor the performance of your supply chain and update the supply chain map as needed. Regularly review and refine the supply chain strategy to adapt to changing market conditions, customer needs, or internal capabilities.

Please consider that mapping the supply chain is an ongoing process and it requires collaboration and information sharing among stakeholders. It provides a foundation for supply chain management, risk assessment and strategic decision-making within an organisation.

### What does it mean?

- In compliance with Article 8 a) of the CSDDD, the company needs to first map its own operations and identify (possible) adverse impacts on environmental or social issues caused by its own operational activities.
- Second, and in alignment with Art. 8 b) of the CSDDD, it is very important for companies to make an effort and gain a clear overview of the different actors involved in their supply chain since many potential adverse impacts/risks occur especially in the first steps of the supply chain (e.g. up to 80 – 95 %, for example for GHG emissions for manufacturing companies of FMCG (i.e. fast moving consumer goods)).
- A better understanding of the supply chain translates into stronger governance and compliance with own corporate policies and values. Integrating supply chain transparency is the best way to build trust between suppliers, companies, and customers.
- How extensively shall the supply chain be mapped? The depth to which a company needs to map its supply chain depends on various factors, including the complexity of the supply chain, the industry in which the company operates, and the specific goals and requirements of the company. While there is no one-size-fits-all answer, here are some general considerations to take into account:
  - Tier 1 suppliers: Mapping the immediate or direct suppliers is typically the starting point for most companies. These are the suppliers that provide goods or services directly to the company. E.g. salad toppings producer supplies to a company manufacturing ready to eat salads or packaging material.
  - Tier 2 suppliers: To gain a deeper understanding of the supply chain Tier 2 suppliers need to be also mapped. These are the suppliers that provide goods or services to the Tier 1 suppliers. Mapping Tier 2 suppliers helps identify potential risks and vulnerabilities further upstream.
  - Beyond Tier 2: In industries with complex or critical supply chains, company's may need to go beyond Tier 2 and map their sub-tier suppliers. These are the suppliers that provide goods or services to the Tier 2 suppliers. Mapping sub-tier suppliers can help identify hidden risks and ensure greater transparency and sustainability throughout the supply chain.
- Critical suppliers: It is crucial for companies to start mapping their critical suppliers first. These are suppliers whose (potential) adverse impacts are significantly impacting the company's operations, reputation, or ability to meet customer demand. Identifying and closely monitoring critical suppliers supports to mitigate risks and develop contingency plans.
- Geographical scope: The depth of supply chain mapping also varies depending on the geographic scope of a company's operations. Companies with global supply chains often need to map suppliers across multiple countries, taking into account factors such as different regulatory environments, cultural practices, and logistical challenges.



- Critical raw materials: Furthermore, sourcing of certain raw materials is often connected to specific geographies where well known environmental issues exist or human rights are underenforced and thus need detailed consideration.

Example 1: For a company that sources palm oil, the procedure would need to include assessing whether palm oil suppliers are involved in deforestation or child labour.

Example 2: The procedure would require evaluating whether mica suppliers (used in toothpaste for shine) are associated with poor labour conditions or environmental harm in mining areas.

- In cases of high-risk supply chains like the example of the tomato supply chain mentioned above, it is necessary to have a thorough transparency, to know where raw materials, components/semi-finished products are produced and under which circumstances.

## Evidence

- Flow chart, table or similar in connection to ESG related risks of the company's own operations (allocated to the relevant topical ESRS, see Annex 3)
- Overviews, lists or database systems with supplier and supply chain data: master data.
- Supplier documents and certifications.
- Updates of the data and update procedures.
- List of identified risks in regard to the supply chain, where each risk is allocated to a topical ESRS (see Annex 3).
- Customer contracts, code of conduct or other forms of requirements with monitoring requirements.
- Records of systematic supplier/supply chain monitoring on client requirements related to legal requirements and the company's code of conduct, to measure compliance and progress towards set goals and to be alerted to possible incidents and violations of stakeholders' rights. This can include mapping (part) of the supply chain per product or product group, collecting third-party audit reports and certificates, collecting quantitative data, e.g. on GHG emissions or water use, or living wage.

Checks: are contents of audit reports analysed to gather insights in the actual status of the ESG impacts? Do certificate standards sufficiently cover the identified risks for the specific product group?

## ANNEX 2 – Developing a supplier code of conduct (CoC)

### **1. Conduct a risk analysis (refer to Annex 3 and 4):**

Based on the policy set up and the outcome of the conducted risk analysis as described in Annex 3 and 4, the company shall develop rules and principles covering expectations on ethical, environmental and business practices which the supplier needs to follow.

### **2. Seek out examples based on industry initiatives or standards**

Many industries and socially responsible companies already have initiatives in place to create a common set of standards around supplier codes of conduct that can be used to model own practices. Examples include the Ethical Trading Initiative, Fair Labor Association and EU Code of Conduct on Responsible Food Business and Marketing Practices.

### **3. Discuss and consult with your business partners, suppliers and other companies operating in your industry**

If your suppliers are working with customers that already have a code of conduct in place, it is helpful to use consistent terminology and processes. Moreover, many industry associations provide good examples on how to set up a code of conduct. It is important to consider – should a template be used – whether all the relevant points apply to the companies' own characteristics and to align where necessary.

### **4. Ensure consistency with the SCRM policies and other codes of practice.**

When writing or adapting the supplier code of conduct, it needs to be ensured that the rules and principles are not conflicting with own policies or other codes of conduct (e.g. from customers or other business partners). Potential conflicts need to be checked carefully to avoid any discrepancy or incongruity between the suppliers' own CoC and other codes that the company received from its customers.

## ANNEX 3 – Conducting the risk analysis

After related risks have been identified and classified into risk factors, a risk analysis has to be conducted for each risk factor identified for a certain product and their raw materials.

### Step 1: Assess likelihood and severity

For each identified risk for the assessed raw materials, the likelihood of occurrence and the severity of this event have to be determined: the probability of occurrence (likelihood) and the level of potential damage (severity) are often determined using a five-point scale (see figure 1); the assessment is made by the responsible employees with the help of historical values and data or scientific literature. Moreover, supplier specific risks need to be gathered by receiving the data from the direct supplier. Here it is necessary to identify what kind of information is needed from your partners and suppliers and the best approach to gather the data.

Severity of impact will be judged by scale, scope and irremediable character. Scale refers to the gravity of the adverse impact.

Scope concerns the reach of the impact, for example the number of individuals that are or will be affected or the extent of the, e.g. environmental damage.

Irremediable character means any limits on the ability to restore the individuals or environment affected by a situation equivalent to their situation before the adverse impact happened.

For political, environmental or social issues, the company should use scientific data, in order to analyse the risk. There are a number of tools already on the market and this area is continuously evolving.

**Remark:** Some helpful tools are available online, to assess the severity on an informed basis. Examples are the WWF Risk Filter (including WWF Water Risk Filter – Country Profiles & WWF Biodiversity Risk Filter – Country Profiles), the human rights toolkit from UNEP, the multi-stakeholder forum INFORM (providing quantitative analysis relevant to humanitarian crises and disasters), the amfori country risk classification or the WRI water risk atlas:

<https://riskfilter.org/>

<https://www.unepfi.org/humanrightstoolkit/index.php>

<https://drmkc.jrc.ec.europa.eu/inform-index/INFORM-Severity/Results-and-data>

<https://www.ottogroup.com/medien/dynamic/docs/de/businesspartnerdeclaration/amfori-countries-risk-classification.pdf>

<https://www.wri.org/applications/aqueduct/water-risk-atlas>

### Step 2: Assign risk scores and determine significance

Assign risk scores based on a combination of likelihood and severity according to the risk matrix.

The result gives an indication about the overall significance of an adverse impact (which is necessary for the next step). The significance of an adverse impact is understood as a function of its likelihood and severity.

### Step 3: Identify critical raw materials

Determining whether a raw material is considered “critical” depends on two factors: if the raw material has a level at or higher than the overall significance that is defined by the company to result in a critical raw material. IFS cannot prescribe the risk priority; this is an individual decision made by the company. However, the reasoning behind this decision should be made on sound judgement and be documented. As a guidance, many companies consider raw materials with an overall significance from medium to severe to be of a critical nature.



## ANNEX 4 – Terms and definitions

### ESG

ESG stands for environmental, social and governance, which are the ESG principles for responsible investing. These principles refer to the practice of including non-financial impacts and sustainable development in the organisation's policies and strategies, and in the evaluation of the organisation by external stakeholders.

### Impact

The effect the undertaking has or could have on the environment and people, including effects on their human rights, connected with its own operations and upstream value chain, including through its products and services, as well as through its business relationships. The impacts can be actual or potential, negative or positive, intended or unintended, and reversible or irreversible. They can arise over the short-, medium-, or long-term. Impacts indicate the undertaking's contribution, negative or positive, to sustainable development.

Commission delegated regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards: [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L\\_202302772](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202302772)

Those who can affect or be affected by the undertaking. There are two main groups of stakeholders:

1. **Affected stakeholders:** individuals or groups whose interests are affected or could be affected – positively or negatively – by the undertaking's activities and its direct and indirect business relationships across its value chain.
2. **Users of sustainability statements:** primary users of general-purpose financial reporting (existing and potential investors, lenders and other creditors including asset managers, credit institutions, insurance undertakings), as well as other users, including the undertaking's business partners, trade unions and social partners, civil society and non-governmental organisations, governments, analysts and academics.

Some, but not all, stakeholders may belong to the two groups.

### Material sustainability matter

A sustainability matter is material from a perspective when it relates to the organisation's significant actual or potential positive or negative impacts on people or the environment over the short-, medium- and long-term. A material sustainability matter from an impact perspective includes impacts connected with the undertaking's own operations and upstream value chain, including through its products and services, as well as through its business relationships.

### Materiality assessment

A process that organisations use to identify and evaluate the impacts, risks, and opportunities most relevant to their sustainability reporting. By conducting this assessment, an organisation determines which sustainability matters are significant enough to disclose to stakeholders. These "material" issues are those that could have notable effects on the organisation's operations, financial performance, or reputation, as well as on broader societal and environmental well-being.

Examples of material topics are: consumer safety, water and effluents, greenhouse gas emissions, human rights in the supply chain. Material topics inform an organisation's sustainability policy and strategy, and corporate reporting.

### **Double materiality assessment**

It expands on this by considering two perspectives: impact materiality and financial materiality. Impact materiality focuses on how an organisation's activities affect the environment and society, while financial materiality examines how sustainability issues could impact the organisation's financial performance. Double materiality recognizes that some issues may be important from both perspectives, and it aims to provide a comprehensive view of sustainability matters that are crucial for both the organisation and its stakeholders.

### **ESRS (European Sustainability Reporting Standards)**

The ESRS are a set of European standards covering ESG themes (divided into 12 sub-categories) aimed at improving the reporting of organisations, by making it more reliable, complete and transparent. They were developed to meet the requirements of the CSRD.

### **Due diligence**

The process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems (OECD, 2011).

### **Supplier code of conduct (CoC)**

Through the CoC, a company communicates what it expects from its suppliers. It ensures that suppliers adhere to high standards of safe working conditions, fair and respectful treatment of employees, and ethical practices. A supplier code of conduct can include these elements, but it is not limited to:

- Labour practice and standards: this includes compliance with child labour laws, anti-discrimination-practices, health and safety standards, working conditions, working hours, wages, right to association and freely chosen employment.
- Environmental responsibility: GHG emissions, soil contamination, energy consumption, generation of waste, etc.
- Business ethics: these components are in place to establish anti-corruption measures, data security and privacy etc., while also adhering to fair business practices and managing partner relationships (e.g. upstream in the supply chain).

### **Supplier risk**

- It refers to the possibility that a supplier may have a negative impact on the activity of a buying company.
- Supplier risk cannot be entirely eliminated. That makes it all the more important that the necessary steps are taken to manage it. It is vital to carry out due diligence, evaluating the risk of any key suppliers to determine whether they pose a threat to the business operation, how easily they could be replaced if needed, and how much it could affect the company if things go wrong.
- Ranking suppliers (risk profiling) and categorising the type of risk can help businesses to be prepared for almost any event.

**Risk analysis**

Due diligence includes a recurring risk analysis to identify potential adverse impacts for stakeholders related to own business operations and the supply chain. Potential adverse impacts are prioritised to enable the organisation to address and act on the impacts, by a mitigation strategy.

**Risk mitigation plan**

Strategy developed by an organisation to identify, evaluate, and address potential risks that could negatively impact its operations, objectives, or stakeholders. The plan outlines specific actions and measures to reduce the likelihood of these risks occurring or to minimise their effects if they do happen. Effective risk mitigation plans help organisations proactively manage uncertainties, ensuring better preparedness and resilience in facing potential challenges related to financial, operational, environmental, or social risks. The risk mitigation plan is provided by the IFS auditXpress Neo Software.

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