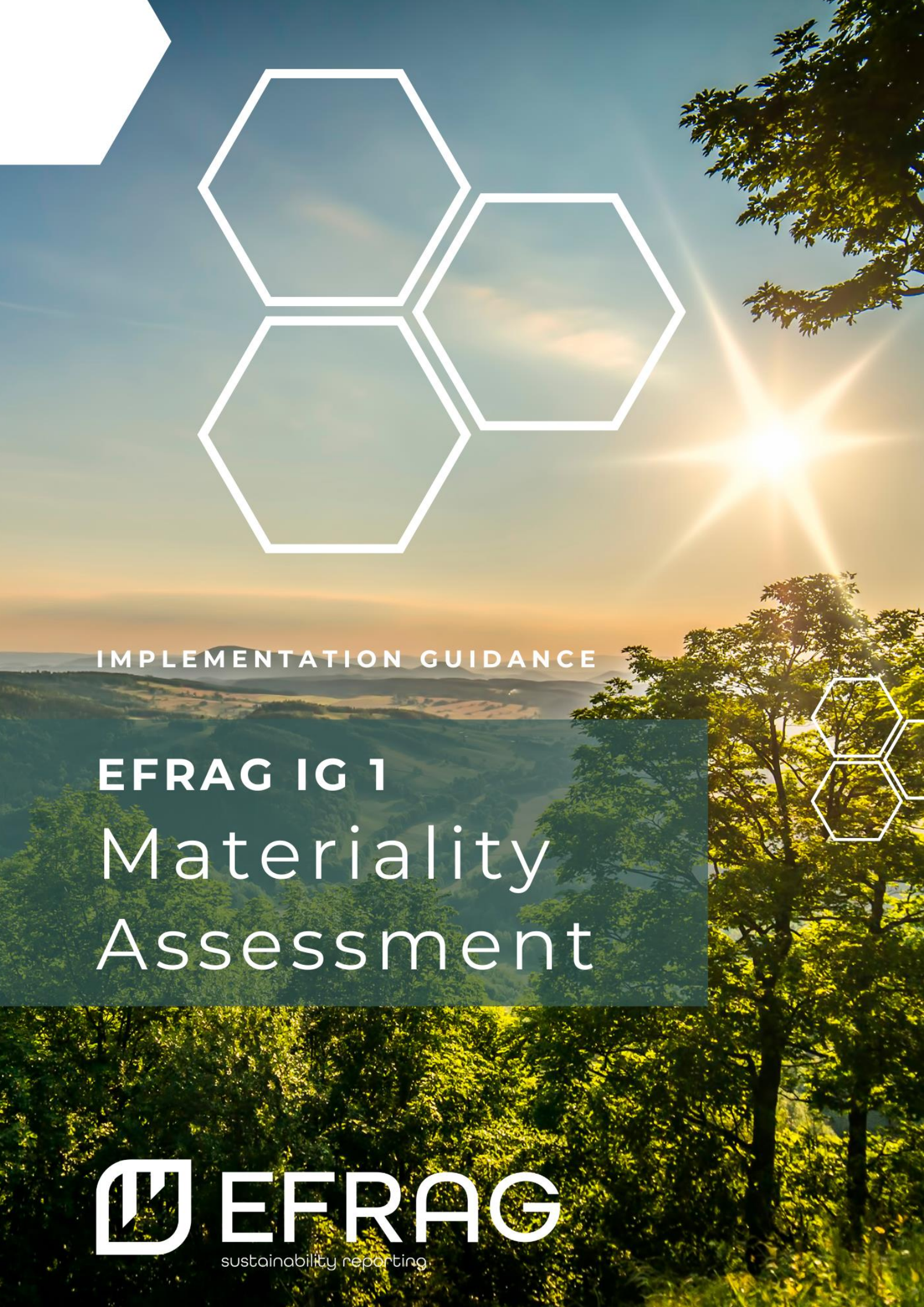

IMPLEMENTATION GUIDANCE

EFRAG IG 1
Materiality Assessment

EFRAG
sustainability reporting

Disclaimer

This implementation guidance is non-authoritative and accompanies the European Sustainability Reporting Standards (ESRS), as stipulated in Articles 19a and 29a of Directive 2013/34/EU (the Accounting Directive), but does not form part of them. This means that if anything in this guidance appears to contradict any requirement or explanation in ESRS, ESRS take precedence. This implementation guidance is issued following EFRAG's due process for such non-authoritative documents and under the sole responsibility of EFRAG.

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This implementation guidance has been developed for use by large listed and unlisted companies that are subject to CSRD. It is therefore not intended for use by listed small and medium-sized enterprises which adopt future LSME standards and other (not listed) SMEs voluntarily reporting based on the future VSME standards.

This implementation guidance relates to the sector-agnostic ESRS as adopted by the European Commission on 31 July 2023, and published in the Official Journal on 22 December 2023. Sector-specific standards may add sector specifications to be followed by specific sectors.

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Summary in 13 key points

1. The ESRS sustainability statement shall include relevant and faithful information about all impacts, risks and opportunities (also referred to as IROs) across environmental, social and governance matters determined to be material from the impact materiality perspective, the financial materiality perspective or both. The materiality assessment is the process by which the undertaking determines material information on sustainability IROs. This is achieved by the determination of material matters and material information to be reported. The performance of a materiality assessment based on objective criteria is pivotal to sustainability reporting. The undertaking will use judgement when applying the criteria, and the related explanations are expected to provide transparency from the undertaking to the users of the sustainability statement.
2. The assessment considers the undertaking's entire value chain, i.e., it includes the undertaking's upstream and downstream value chain in addition to its own operations.
3. Once the undertaking has identified an impact, risk or opportunity related to a sustainability matter as material, it firstly refers to the related Disclosure Requirements to identify the relevant information to be considered on the matter. Secondly, if the impact, risk or opportunity is not covered or insufficiently covered by the ESRS, the undertaking shall provide entity-specific disclosure on the matter. Relevance is the criterion to identify the information to be disclosed and is based on (a) the significance of the information in relation to the matter it depicts or (b) its decision-usefulness.
4. Disclosure Requirements in ESRS 2 addressing cross-cutting matters are to be reported irrespective of the outcome of the materiality assessment. For policies, actions and targets, information shall either be disclosed according to the Disclosure Requirements or it shall be stated that the undertaking does not have policies, actions or targets related to the material sustainability matter. Metrics are subject to materiality assessment: the information defined in the relevant Disclosure Requirements shall be included when the undertaking has assessed the metrics to be material and it is omitted if this is not the case. Having followed a structured materiality assessment, such an omission indicates to users that a metric is not material. Omissions are useful sustainability-related information, supporting the general coherence of the sustainability statement and, therefore, the fair coverage of sustainability matters. The omission is explicit for datapoints derived from other EU legislation (refer to ESRS 2 Appendix B for the list of these datapoints) and implicit in other cases.
5. The ESRS do not mandate a specific process or sequence of steps to follow when performing the materiality assessment, and so this is left to the judgement of the undertaking. Whichever process is used, it should reflect the undertaking's facts and circumstances.
6. As an illustration, a materiality assessment that would meet the requirements of the ESRS could include the following steps:

    (a) understanding of the context;

(b) identification of actual and potential IROs related to sustainability matters;

(c) assessment and determination of the material IROs related to sustainability matters; and

(d) reporting.

7. Engagement with affected stakeholders informs the materiality assessment process, and it is consistent with the practice suggested by the international instruments of due diligence referenced in the CSRD. This entails seeking input and feedback to understand concerns and evidence about actual and potential impacts of the undertaking on people and the environment. It also helps to substantiate the importance of the sustainability matters from the perspective of the affected stakeholder groups. However, the ESRS do not mandate specific behaviour on stakeholder engagement and do not pre-empt the content of the CSDDD currently under definition in the EU legislative process.

8. The undertaking assesses the materiality of impacts for reporting purposes against criteria of severity and likelihood. This also includes setting appropriate quantitative and/or qualitative thresholds for reporting purposes. Severity is based on the scale, scope and irremediable character of negative impacts and the scale and scope of positive impacts.

9. Material risks and opportunities for the undertaking generally derive either from impacts or from dependencies and other risk factors. Undertakings assess the materiality of their risks and opportunities based on appropriate quantitative and/or qualitative thresholds related to anticipated financial effects on performance, financial position cash flows and access to finance, including cost of capital.

10. The due diligence process, per the related international instruments, can help an undertaking both (a) to identify and assess its actual and potential negative impacts as well as (b) to assess their materiality for reporting purposes based on the criteria of severity and likelihood.

11. When undertakings perform an assessment under the GRI Universal Standards, the GRI assessment constitutes a good basis for the assessment of impacts under the ESRS.

12. An undertaking that applies the ESRS is expected to be able to comply with the identification of sustainability-related information on risks and opportunities under IFRS Sustainability Disclosure Standards (also known as ISSB Standards). This reflects an alignment in scope between financial materiality in ISSB standards and the ESRS.

13. Upon completing the materiality assessment process, the undertaking shall disclose:

(a) the process to identify and assess its material IROs (ESRS 2 IRO-1);

(b) the interaction of its material IROs with its strategy and business model (ESRS 2 SBM-3); and

(c) the Disclosure Requirements under the ESRS covered by its sustainability statement (ESRS 2 IRO-2).

1. Introduction

14. The objective of this non-authoritative Guidance is to support the implementation activities of preparers and others using or analysing ESRS reports with regard to the double materiality assessment (referred to as 'the materiality assessment', 'the assessment' and 'the MA' in this document). Hence, this Guidance does not introduce new provisions to the ESRS as these can only result from future standard-setting activities (e.g., future possible amendments to draft ESRS) conducted in accordance with EFRAG's due process. Where content in this Guidance is seen to contradict the requirements in the ESRS, those requirements supersede.

15. Due to the principles-based nature of the ESRS requirements – particularly on this topic – there is no single solution for all undertakings in respect of designing processes and adopting methodologies. Hence, this Guidance provides tools and mechanisms for undertakings to comply with the ESRS while taking full account of their specific facts and circumstances (including their business model, strategy, legal structure, complexity and governance). Therefore, the illustrations on how to apply the criteria in ESRS 1 *General requirements* and ESRS 2 *General disclosures* in this Guidance, including examples and depictions, do not constitute the only possible approach to implementing the ESRS requirements.

16. The content of this document has been developed by EFRAG on the basis of the July 2023 Delegated Act on the ESRS adopted regulation, in accordance with the requirements of Articles 19a and 29a of the Directive 2013/34/EU (referred to as the 'Accounting Directive') as amended following the Corporate Sustainability Reporting Directive (referred to as 'the CSRD').

17. This Guidance includes responses to FAQs on the interoperability with ISSB and GRI Universal Standards, illustrating the interactions between the corresponding materiality concepts and assessment processes when applicable.

18. This Guidance also includes responses to FAQs related to international instruments and to reporting standards that will be useful when performing the materiality assessment and that are referenced in the CSRD. In the case of due diligence, these are the *Guiding Principles on Business and Human Rights* issued by the United Nations as well as the *OECD Guidelines for Multinational Enterprises* and the *OECD Due Diligence Guidance for Responsible Business Conduct,* which have been used as a basis for the preparation of this document. This Guidance acknowledges that market practice is currently developing for double materiality assessment and that there are still no examples of sustainability statements prepared under the ESRS.

Structure of the Guidance

19. This document is organised as follows:

    (a) Chapter 2 explains the ESRS approach to materiality;

    (b) Chapter 3 illustrates how the materiality assessment is performed;

(c) Chapter 4 explains how undertakings could take account of other frameworks/standards or sources; and

(d) Chapter 5 complements chapters 2 to 4 with responses to FAQs on:

i. impact materiality;

ii. financial materiality;

iii. the materiality assessment process;

iv. stakeholder engagement;

v. aggregation/disaggregation; and

vi. reporting.

Cross-references to IG 2

20. To avoid duplication and reduce the length of this document, there is significant reference to the Value Chain Implementation Guidance (IG 2) developed by EFRAG. In-depth analysis and further examples of due diligence aspects related to the materiality assessment (as well as some VC aspects) are covered in that guidance more so than here.

21. Please note that references to IG 2 are made in this blue colour, whereas references in green refer to this document.

Acronyms and abbreviations used

22. The acronyms in this document are used as follows:

Refer to the Delegated Act
Annex II: Acronyms and glossary of terms

CSDDD – Corporate Sustainability Due Diligence Directive

CSRD – Corporate Sustainability Reporting Directive

Delegated Act – Commission Delegated Regulation supplementing Directive 2013/34/EU as regards sustainability reporting standards

DR – disclosure requirement

ESRS – European Sustainability Reporting Standards

GHG – greenhouse gases, or the GHG protocol

GRI – Global Reporting Initiative

IROs – impacts, risks and opportunities

ISSB – International Sustainability Standards Board

MA – materiality assessment

IG 2 – Value Chain Implementation Guidance issued by EFRAG

IG – Implementation Guidance issued by EFRAG

OECD MNE– OECD Guidelines for Multinational Enterprises (also referred to as 'the OECD Guidelines')

SFDR – Sustainable Finance Disclosure Regulation[1]

UNGP – United Nations Guiding Principles on Business and Human Rights.

2. The ESRS approach to materiality

23. The ESRS require that the sustainability statement include sustainability information related to material IROs identified through a MA process that applies the principles of double materiality.

24. Double materiality covers both impact and financial materiality. Impact materiality pertains to the material information about the undertaking's impacts on people or the environment related to a sustainability matter; financial materiality pertains to the material information about risks and opportunities related to a sustainability matter. The terms 'material' and 'materiality' are used throughout the ESRS to refer to double materiality unless otherwise specified (also referred to in this document as 'materiality').

25. The identification of the material matters is the starting point to determine the material information to be disclosed in the sustainability statement on material IROs related to those matters. Material IROs related to environmental, social and governance matters that are to be reported are those that arise in the undertaking's own operations as well as in its upstream and downstream value chain. If the MA process is not appropriately designed, the undertaking may provide incomplete reporting (with material IROs not being disclosed). Following the provisions in ESRS 1 paragraph 114, in addition to the disclosure of material matters identified during the MA process, the undertaking may provide additional information stemming from other legislation as well as from generally accepted sustainability reporting standards and frameworks (for example, SASB Standards or GRI Standards). This may include additional information that is required by stakeholders.

26. If the undertaking identifies a large number of IROs, it may prioritise them for management purposes. However, for reporting purposes this assessment should not exclude any material IROs, particularly when the undertaking has not addressed or fully addressed these material IROs through its policies, targets and action plans. This is useful information and shall therefore be included irrespective of whether actions have been taken, or are planned to be taken, to address them (refer to ESRS 2 MDR-P, MDR-A and MDR-T).

27. ESRS 1 sets criteria for the materiality assessment but not specific thresholds to determine when a matter or information is material or not. Therefore, the assessment requires the exercise of judgement. The undertaking needs to set thresholds based on ESRS 1 criteria as well as its own specific facts and circumstances. The need for judgement will be higher whenever the information and evidence about the materiality of a given IRO is inconclusive.

28. The sustainability statement shall be prepared according to the qualitative characteristics of information (refer to ESRS 1 and Appendix B). For materiality-

[1] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (Sustainable Finance Disclosures Regulation) (OJ L 317, 9.12.2019, p. 1).

assessment-related disclosures, relevance, faithful representation and verifiability of information are particularly important. The materiality assessment should be based upon supportable evidence and rely to the maximum extent possible, on objective information, while implementing the impact materiality and financial materiality criteria specified in the ESRS (ESRS 1 chapters 3.4 and 3.5).

29. The ESRS require undertakings to disclose the materiality assessment process and its outcome. This includes the following information: methodologies and assumptions applied, the focus and extent of the process, and inputs. ESRS 2 IRO-1 and IRO-2 also require transparency on the judgement exercised, i.e. quantitative or qualitative thresholds and other criteria used. Refer to Chapter 3.6 *Deep dive into impact materiality – Setting thresholds* and Chapter 3.7 *Deep dive into financial materiality – Setting thresholds* in this Guidance for more information.

30. To meet the required qualitative characteristics of information (Appendix B of ESRS 1), the MA process (including criteria and thresholds applied as well as conclusions) should be consistent with internal and other external reporting. Consistency with sustainability management policies and actions is also required, including fulfilling sustainability-related laws and regulations.

31. The undertaking may briefly explain the conclusions of its materiality assessment in relation to any omitted topic or topics. However, the undertaking is required to provide explanations if it concludes that it has no material IROs with respect to climate change and therefore omits disclosures required per ESRS E1 *Climate Change*. The undertaking shall also report on material matters that are not covered or that are covered insufficiently in the topical ESRS in the form of entity-specific information (ESRS 1 paragraph 11).

32. Once the undertaking has identified the material matters, it then assesses the information to be reported for each material matter based on the materiality of information (ESRS 1 paragraphs 30, 31, 33 and 34). The concept of materiality of information applies to the requirements at a more granular level, i.e., at the Disclosure Requirement or the datapoint level. Refer to Chapter 2.3 *Criteria to determine the materiality of information* and Chapter 2.4 *Scope of application of the materiality of information.* for more on this granular application of the concept.

2.1 Implementing the concept of double materiality

33. As discussed above, the CSRD requires that sustainability reporting be based on double materiality. A sustainability matter can be material from an impact perspective, from a financial perspective or from both (see ESRS 1 Chapter 3; refer to figure 1 (a) below).

34. The ESRS include definitions of these two materiality dimensions. A sustainability matter is material from:

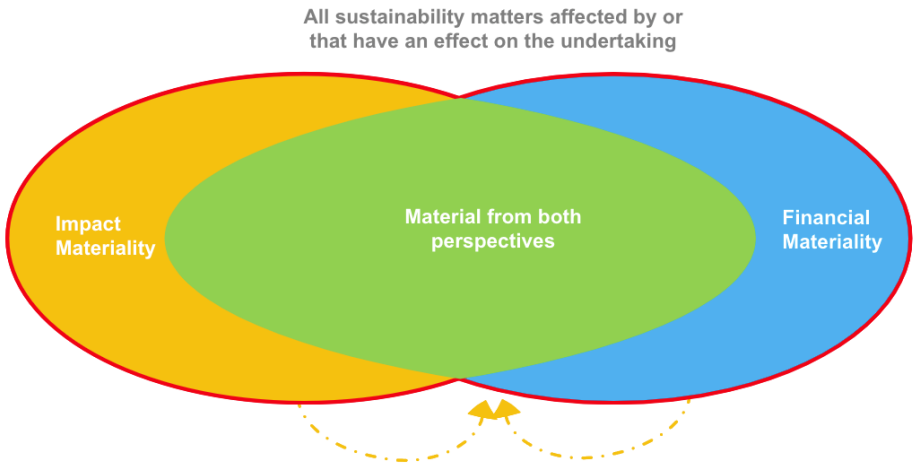
    (a) 'an impact perspective when it pertains to the undertaking's material actual or potential, positive or negative impacts on people or the environment over the short-, medium- and long-term. Impacts include those connected with the undertaking's own operations and the upstream and downstream value chain, including through its products

and services, as well as through its business relationships' (ESRS 1 paragraph 43); and from

(b) 'a financial perspective if it triggers or could reasonably be expected to trigger material financial effects on the undertaking. This is the case when a sustainability matter generates risks or opportunities that have a material influence or that could reasonably be expected to have a material influence on the undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term … The financial materiality assessment corresponds to the identification of information that is considered material for primary users of general-purpose financial reports in making decisions relating to providing resources to the entity. In particular, information is considered material for primary users of general-purpose financial reports if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the undertaking's sustainability statement' (ESRS 1 paragraphs 49 and 48). In this document, the terms "risks" and "opportunities" are used to identify the financial risks and opportunities that are in the scope of financial materiality.'

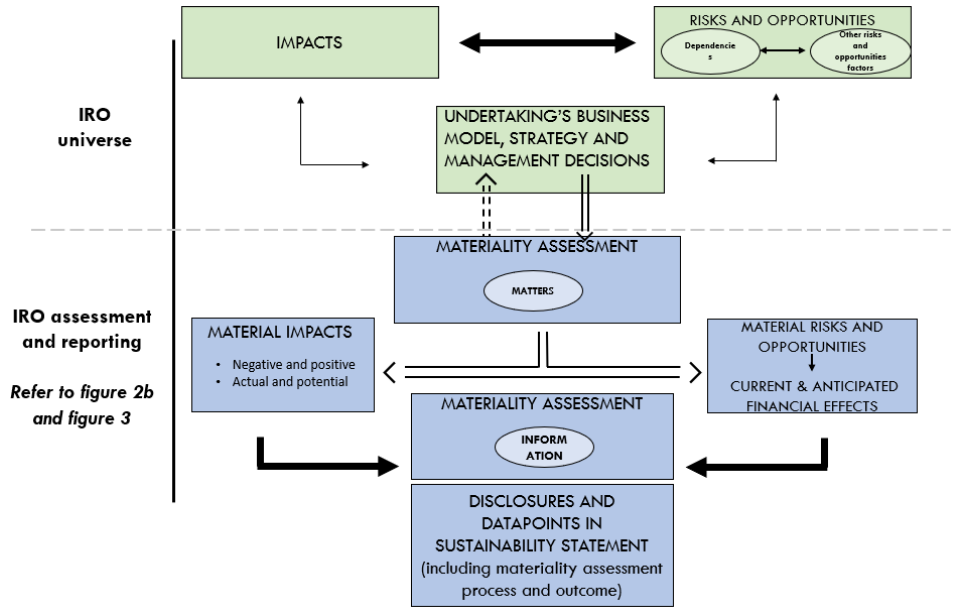
35. Impact materiality and financial materiality are often intertwined (refer to figure 1(a) and 1(b) below). The undertaking's impacts on people or the environment, combined with changes to strategy – including in investments – as well as in management decisions made to address such impacts, may give rise to risks and opportunities. Material risks and opportunities generally derive from impacts and dependencies.

Figure 1(a). Double materiality – The scope is reflected by the red outline



Caveat: for illustration only – the dimensions in the graph do not necessarily represent the expected overlap (green) between financial and impact materiality nor the relative perimeters of impact materiality (orange) versus financial materiality (blue). For most material impacts, a risk or opportunity related to that impact may emerge over time.

Figure 1(b). Relationship between the materiality assessment and the undertaking's business model, strategy and other decisions



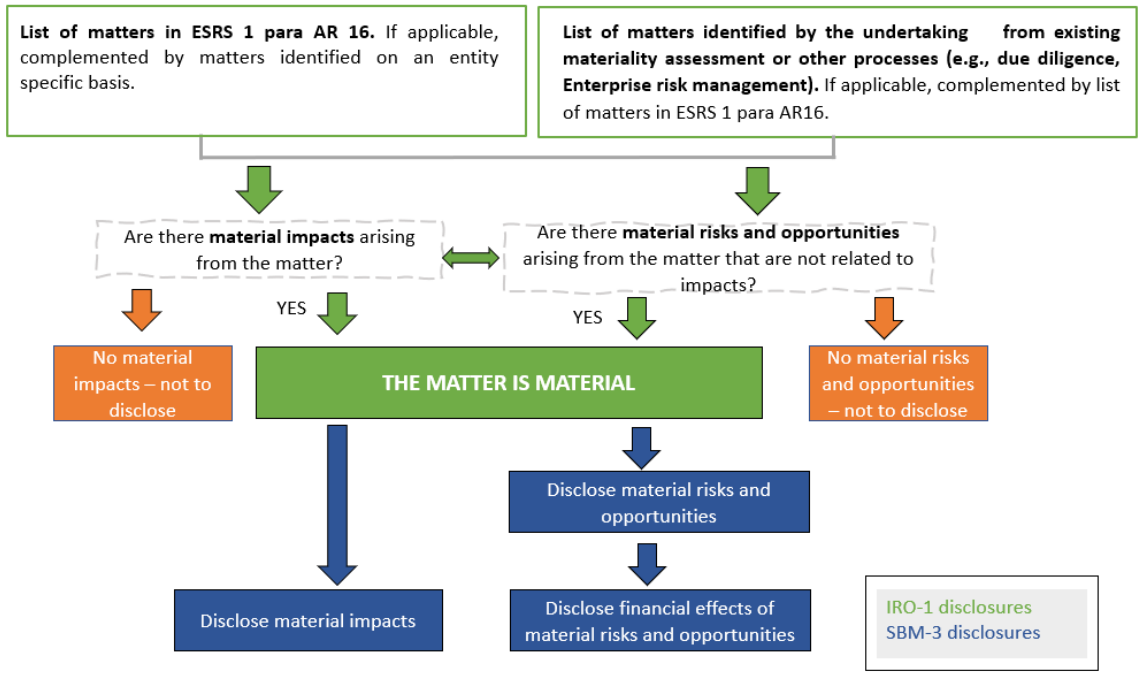
Influence of impacts, dependencies and other R&O factors on undertaking's business model, strategy and decisions, including OPEX, CAPEX, etc.

Materiality assessment inputs and process

Influence of materiality assessment on undertaking's decisions

Materiality assessment outcome in terms of sustainability reporting

Figure 1(c). Interaction between ESRS 1 paragraph AR 16 and the assessment of material impacts, risks and opportunities.



36. A possible practical perspective in the MA process considering both impact and financial materiality is summarised below (refer to figure 1(b) above):

    (a) identification of impacts;

    (b) assessment of whether such impacts lead to risks and opportunities (refer to paragraph 37 below). This includes, but is not limited to, risks and opportunities that derive from dependencies on resources; and

    (c) identification of risks and opportunities not sourced from impacts (refer to paragraph 38 below for examples). This includes, but is not limited to, those risks and opportunities that derive from dependencies, where impacts do not affect that resource[2].

37. For most material impacts, a material risk and/or opportunity may emerge over time. The examples on next page include negative and positive impacts.

[2] The undertaking shall consider how it is affected by its dependencies on the availability of natural, human and social resources at appropriate prices and quality irrespective of its potential impacts on those resources (ESRS 1 paragraph 40).

(a) An oil and gas undertaking identifies a material negative impact from not consulting or reaching an agreement with indigenous people about land use for extraction and relocation of the community. At the reporting date, the undertaking does not expect protests from the indigenous community. However, the community may later protest, halting the production site, causing material costs due to production days lost or the abandonment of the project.

(b) An undertaking has discriminated based on gender when promoting employees during the current reporting year. At the reporting date, the undertaking does not expect that the employees will pursue legal proceedings. However, the group of employees, individually or as a whole, may sue for financial compensation at a later stage on the grounds of gender discrimination and cause reputational damage to the undertaking.

Interaction between impact and financial materiality

Materiality of a matter is determined by either (i) material impacts or (ii) material risks and opportunities. A matter can also be material from both perspectives.

When a matter is material due to impact materiality, the same material matter may or may not result in material risks and/or material opportunities. Most of the material matters also give rise to financial risks and/or opportunities.

It is only when an undertaking identifies that material risks and/or opportunities exist that the undertaking discloses the financial effects relating to the matter.

However, where a matter is material due to its impacts only, the undertaking does not have to disclose risks and opportunities (or its related financial effects) that are not material.

38. Material risks and opportunities also arise in the absence of material impacts connected to the undertaking, such as when they arise from dependencies on natural and human resources. Consider, for example, cases such as the following:

(a) an undertaking is active in organic agriculture, which depends on pollinators. The number of pollinators is decreasing due to pesticide use by other agricultural entities locally;

(b) an undertaking with a factory running on renewable energy producing low GHG emissions. The undertaking is located in a coastal erosion area and is exposed to climate-related physical risks, such as flooding or extreme weather; and

(c) an undertaking that provides legal services to its customers may experience an elevated level of staff turnover caused by a local competitor offering higher salaries, even if both undertakings have adequate working conditions and practices. Therefore, the undertaking dependent on human capital may experience lower income until new staff is recruited.

39. Sustainability-related regulatory developments that address systemic risks may affect the prospects of the undertaking's business. For example, risks can arise from changes in the regulatory environment, such as a new pollution

abatement legislation that requires significant capital expenditure and exposes the undertaking to sanctions.

40. Impact and financial materiality are two different but interrelated concepts, and the interconnections between them shall be considered. This consideration may require the application of judgement when organising the materiality assessment, including on whether or not the two processes should be divided in two or whether, should there be common steps among these processes, . However, there is merit to maximising synergies among the two processes to avoid gaps. Figure 1(c) above illustrates such synergies and how ESRS 1 AR 16 is a common denominator for both impact and financial materiality.

2.2 Sustainability matters for the materiality assessment

41. Sustainability matters are defined in the *Annex 2* of the Delegated Act as environmental, social and human rights as well as governance factors, including sustainability factors defined in Article 2, point (24), of Regulation (EU) 2019/2088 (i.e., SFDR).

42. The level of granularity of the matters to be considered ranges from topic to subtopic level and, in some cases, to sub-subtopic level. The following table is an extract from ESRS 1 AR 16 and sets out the relationship between topics, subtopics and sub-subtopics (refer also to Figure 3 below).

Standard	Topic	Subtopic	Sub-subtopic
ESRS E3	• Water and marine resources	• Water • Marine resources	• Water consumption • Water withdrawals • Water discharges
ESRS S1	• Own workforce	• Other work-related rights	• Child labour • Forced labour • Adequate housing • Privacy
ESRS G1	• Business conduct	• Corruption and bribery	• Prevention and detection • Incidents

43. As described in ESRS 1 paragraph 8, the three levels of granularity (i.e., topics, subtopics and sub-subtopics) are collectively called 'sustainability matters'.

44. To summarise:

    (a) the goal of the assessment is to identify the material IROs related to matters to be reported (ESRS 2 SBM 3);

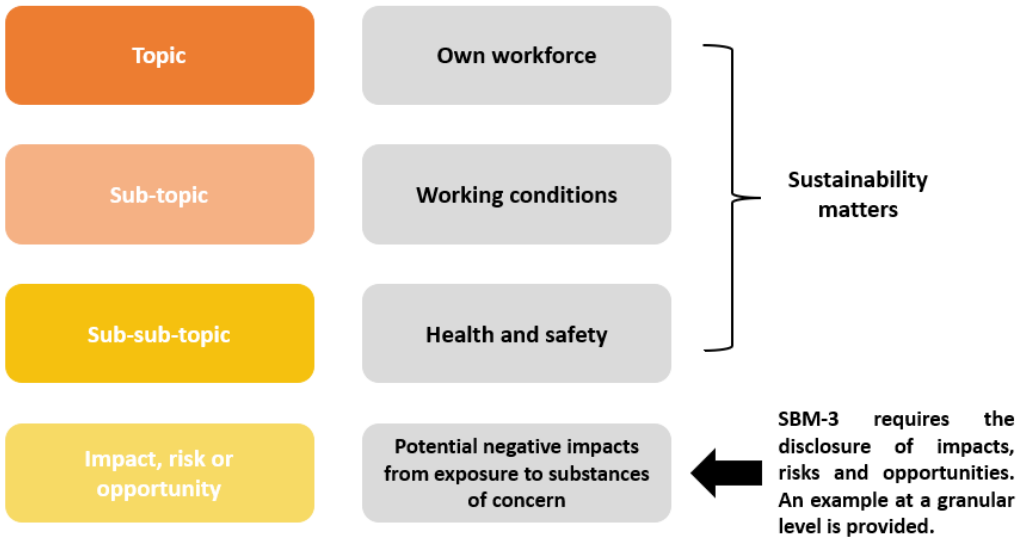
    (b) the matter is assessed as material when material impacts and/or material risks or opportunities arise from it (ESRS 1 paragraph 43 and 49); and

    (c) for each material matter, the undertaking determines the information to be reported in accordance with the cross-cutting or topical standards (ESRS 1 paragraph 30).

45. The undertaking is required to disclose its material IROs, which are in turn mapped onto sustainability matters (i.e., topics, subtopics or sub-subtopics). In preparing its disclosure according to ESRS 2 SBM-3, the aggregation rules

defined in ESRS 1 Chapter 3.7 also apply, which means that the undertaking may aggregate information to the extent that it does not obscure material content (ESRS 1 chapter 3.7). For more on this, refer to figure 2 below.

Figure 2. Relationships amongst various terms used



46. The undertaking needs to identify whether a topic, subtopic or sub-subtopic is material from any of these two perspectives because the matter is associated with either an identified material impact, risk or opportunity or both.

47. Once a matter has been identified as material, the undertaking refers to the DR in the respective topical ESRS to identify the information to be disclosed on the matter (ESRS 1 paragraphs 30 and 31). For example, if an undertaking concludes that health and safety of its own workforce is material due to the employees' exposure to harmful chemical substances, it shall provide the required information. This includes the disclosure requirements in ESRS S1-1 *Policies*, S1-4 *Taking action*, S1-5 *Targets*, and S1-14 *Health and safety metrics*. Similarly, if an undertaking concludes that pollution of water is material, it shall provide information under the DR in ESRS E2-1 *Policies*, E2-2 *Actions and resources*, E2-3 *Targets*, E2-4 *Pollution of air, water and soil and* E2-6 *Anticipated financial effects from material polluted-related risks and opportunities*.

48. In addition, as specified in paragraph 31, in some situations where a sustainability matter is identified as material but is not covered by a ESRS (see ESRS 1 paragraph AR 16 for a full list of matters) or not covered with sufficient granularity by it, the undertaking shall provide additional entity-specific disclosures (ESRS 1 paragraph 11).

49. In summary, once a given matter is assessed to be material, the information to be disclosed is identified at the matter level following the datapoints of the relevant DR in the topical standards. However, the outcome of the materiality

assessment (ESRS 2 SBM-3) is to be disclosed at the level of impacts, risks and opportunities (or groups of them).

2.3 Criteria to determine the materiality of information

50. Determining the materiality of information is a step that follows from the identification of material matters to be reported on (see Chapter 3 *Materiality assessment – how is it performed?*), and it is applied at the more granular level of DRs or datapoints. ESRS 1 paragraphs 31 and 33 to 35 set requirements on how to assess the materiality of information.

51. The criteria to determine the materiality of information is based on relevance (ESRS 1 paragraph 31): that is, on (a) the significance of the information in relation to the matter it depicts or its (b) decision-usefulness. This is relevant for the primary users of general-purpose financial information (i.e., financial materiality-focused) and/or for other users whose interest is on the undertaking's impacts (i.e., impact materiality). In practice, information that is relevant under perspective (b) (decision-usefulness) is in most cases also relevant under perspective (a) (significance). However, there could be cases where a piece of information is significant to depict the impacts of the undertaking on people or the environment without necessarily being a relevant input for the users of the sustainability statement in its decision-making. When a matter is material from both an impact and a financial perspective, the information needs from the two groups of users (investors and others) will highly likely be the same in practice. In other cases, the information may differ (refer to FAQ 21 *If a matter is material from the financial (or impact) perspective only, should disclosures cover all the requirements or only information about the relevant perspective?)*.

52. In addition, the undertaking needs to apply the general requirements on fundamental qualitative characteristics of information (relevance and faithful representation) and the enhancing qualitative characteristics of information (comparability, verifiability and understandability) (ESRS 1 Appendix B).

53. ESRS 2 IRO-2 requires an explanation of the determination of the information to be disclosed in relation to the material IROs (i.e., materiality of information), including the use of thresholds and/or how it has implemented the criteria in ESRS 1 Chapter 3.2 *Material matters and materiality of information*.

54. An example of a materiality filter, when assessing which information in a topical standard has to be provided (materiality of information), applies in the case where the undertaking assesses labour rights (including collective bargaining) as material. In this particular case, the undertaking concludes that the datapoint under ESRS S1 paragraph 61 is not material information because all employees are covered by collective bargaining agreements, according to the disclosures of ESRS S1 paragraph 60(a)(b).

2.4 Scope of application of the materiality of information

55. The following paragraphs illustrate how the undertaking shall apply the filter of materiality of information (see ESRS 1 paragraphs 31, 33-35) when disclosing information on material sustainability matters.

56. The determination of the information to be reported for policies, actions and targets in relation to a material matter is set out in the list of Minimum Disclosure Requirements on policies, actions and targets (see Chapter 4.2 *Minimum Disclosure Requirements on policies and actions* and Chapter 5 *Metrics and targets* in ESRS 2); the information is not required for topics, subtopics or sub-subtopics that are not deemed material. The datapoints in the Minimum Disclosure Requirements depict the relevant information to a user to assess the policies, actions and targets in relation to a material matter. In addition, the filter of materiality of information (ESRS 1 paragraph 31) is applied in determining the granularity of the description of the policies, actions and targets. If the undertaking has not adopted policies, actions or targets to manage a given material matter, it has to state this much, but no additional information is required. There is also a voluntary disclosure on the timeline to adopt such policies, actions or targets (ESRS 1 paragraph 33). Reporting that the undertaking does not have policies, actions or targets for a material matter is per se a material piece of information – even if no other information is required.

57. The determination of metrics to be reported is informed by the assessment of material information ('shall include' the information assessed to be material, ESRS 1 paragraph 34). This is performed first at the level of the DR and secondly at the level of the related datapoints located either in the DR[3] or, when applicable, in Application Requirements. When the information required by a DR or a datapoint is assessed to be not material (per ESRS 1 paragraph 31), and for datapoints not needed in order to meet the objective of the Disclosure Requirement, the undertaking 'may omit' such information (ESRS 1 paragraph 34).

58. The criteria to determine the materiality of information (ESRS 1 paragraph 31) are also expected to support the determination of entity-specific disclosures (ESRS 1 paragraph 30(b) and ESRS 1 paragraph 11 and paragraphs AR 1-5). This ensures that entity-specific disclosures meet the qualitative characteristics of information and include all material information.

59. The DRs and datapoints in ESRS 2 are to be reported irrespective of the outcome of the materiality assessment. In this case, the criteria to assess the materiality of information (ESRS 1 paragraph 31) are expected to support the determination of the level of detail of narrative disclosure that is necessary to meet the Disclosure Requirements in ESRS 2 (ESRS 1 paragraph 31 refer to the 'applicable information').

2.5 Datapoints derived from EU legislation

60. When the undertaking omits a datapoint derived from other EU legislation listed in ESRS 2 Appendix B *List of datapoints in cross-cutting and topical standards that derive from other EU legislation* because it is not considered material, the undertaking has to include an explicit statement saying that such a datapoint is 'not material'. ESRS 2 paragraph 56 requires that the undertaking include in the sustainability statement a table of all the datapoints in ESRS 2 Appendix B *List of datapoints in cross-cutting and topical standards*

[3] For ESRS E1, this applies also for datapoints located in Application Requirements.

that derive from other EU legislation. Such table shall specify where the datapoints can be found in the statement, and for those that are omitted as not material, it shall report that the respective datapoint is not material. The majority of these datapoints in Appendix B are derived from the SFDR and are therefore used by financial market participants, who are also users of the sustainability statement. Hence, these datapoints may be relevant for these users and analysts.

61. These datapoints are treated similarly to other datapoints for the purposes of assessing the information to be reported on a material matter – i.e., those related to policies, targets and actions follow ESRS 1 paragraph 33, and those related to metrics are omitted if not material (ESRS 1 paragraph 34).

2.6 Consideration for upstream/downstream value chain

62. The materiality assessment is also used to identify material IROs connected to the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain (for further details, seeIG 2 *Value Chain Implementation Guidance*).

3. How is the materiality assessment performed?

63. The ESRS do not mandate how the materiality assessment process shall be designed or conducted by an undertaking. This is because no one process would suit all types of economic activity, organisational structure, location of operations or upstream and downstream value chains of all undertakings applying the ESRS.

64. Therefore, an undertaking shall design a process that is fit for these purposes based on its specific facts and circumstances, including consideration of the depth of the assessment, as per the requirements of ESRS 1 Chapter 3 and of the DRs regarding the materiality assessment and its outcome (see ESRS 2 IRO-1, IRO-2 and SBM-3). In any case, an undertaking shall consider the full scope of environmental, social and governance matters (i.e., sustainability matters) as listed in ESRS 1 paragraph AR16 as well as any other matter that is material from an entity-specific perspective.

65. The undertaking's materiality assessment shall reflect both the impact and financial materiality perspectives, as well as interconnections between the two, but need not perform two separate and independent processes. The identification of material impacts is generally a starting point since the financial materiality assessment benefits from the outcome of the impact materiality assessment (see ESRS 1 Chapter 3.3 *Double materiality*). The reason for this is that material impacts trigger in most cases material risks and opportunities. However, the undertaking shall also consider the possible matters that are financially material only and may develop a step or a series of actions that are specific to financial materiality. Finally, there may also be impacts deriving from risks and opportunities and from the way that those risks and opportunities are managed by the undertaking.

66. By way of illustration, a materiality assessment aligned with the ESRS could follow the process outlined below, including four possible steps:

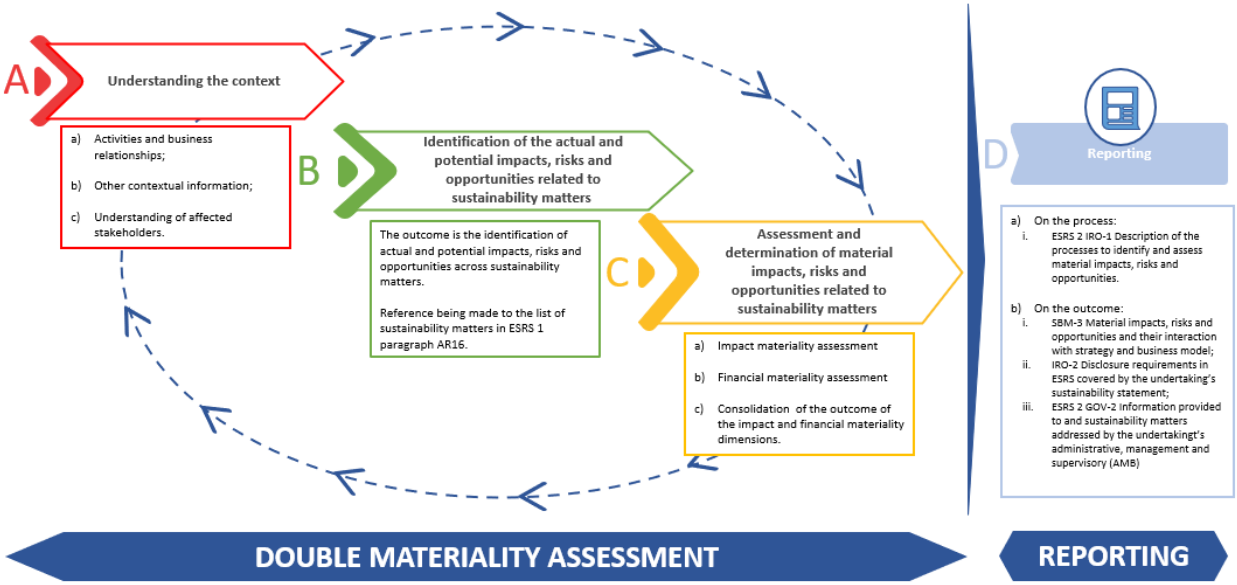
(a) Step A: Understanding the context;

(b) Step B: Identification of the actual and potential IROs related to sustainability matters;

(c) Step C: Assessment and determination of the material IROs related to sustainability matters; and

(d) Step D: Reporting.

Figure 3. Example of a materiality assessment process



67. Chapter 5.3 *FAQs on the materiality assessment process* provides further guidance, with specific FAQs on the process.

3.1 Step A: Understanding the context

68. In this step, the undertaking develops an overview of its activities and business relationships, the context in which these take place and an understanding of its key affected stakeholders. This overview provides key inputs to identify the undertaking's IROs.

Activities and business relationships

69. Activities and business relationships related to ESRS 2 SBM-1 are approached in terms of:

(a) the analysis of the undertaking's business plan, strategy, financial statements and, when applicable, other information provided to investors;

(b) the undertaking's activities, products/services and the geographic locations of these activities; and

(c) the mapping of the undertaking's business relationships and upstream and/or downstream value chain, including type and nature of business relationships.

Other contextual information

70. There are other factors that can help identify particular sources of IROs, such as:

(a) the analysis of the undertaking's relevant legal and regulatory landscape; and

(b) the analysis of published documentation, such as media reports, analysis of peers, existing sector-specific benchmarks and other publications on general sustainability trends as well as scientific articles.

Understanding of affected stakeholders

71. This is aimed at understanding which stakeholders are or are likely to be affected by the undertaking's own operations and upstream and downstream value chain (see Chapter 3.5 *Role and approach to stakeholders in the materiality assessment process*). It also includes their views and interests (consistent with the disclosures per ESRS 2 SBM-2 *Interests and views of stakeholders*). Based on this, the undertaking can identify its key affected stakeholders. The following can be considered to aid such understanding:

(a) an analysis of the existing stakeholder engagement initiatives (such as via communication, investor relations, business management, sales and procurement teams); and

(b) a mapping of affected stakeholders across the undertaking's activities and business relationships. Separate groups of affected stakeholders may be identified per activity, product or service and are to be prioritised for a particular sustainability matter (this mapping may be reviewed after Step B as needed).

72. Chapter 5.4 FAQ on stakeholder engagement provides further guidance on the role of stakeholders.

3.2 Step B: Identification of the actual and potential impacts, risks and opportunities related to sustainability matters

73. In this step, the undertaking identifies the actual and potential impacts, risks and opportunities (IROs) relating to environmental, social and governance matters across its own operations and in its upstream and downstream value chain. The outcome will be a 'long' list of impacts, risks and opportunities for further assessment and analysis in subsequent steps (see section 3.3).

74. The undertaking should use the list of the sustainability matters in ESRS 1 paragraph AR16 to support this process and to ensure completeness. In some cases, it may also use the actual disclosure requirements and related Application Requirements in the topical standards; for example, the ESRS S1-10 metric on adequate wages and its accompanying calculation methodology

in ESRS S1 paragraph AR73 may help to assess whether the sub-subtopic 'adequate wages' is material. It is equally important for the undertaking to consider entity-specific sustainability matters not covered in that list, if any. Currently, until the sector standards are issued, sector sustainability matters have to be identified and assessed as entity-specific matters. The available best practices, frameworks and/or other reporting standards, such as the IFRS industry-based guidance and GRI Sector Standards (ESRS 1 paragraph 131(b)), are possible resources to be used for the identification of entity-specific matters, especially whilst the sector-specific standards are not issued.

75. *[Draft] EFRAG IG 3 – List of ESRS Datapoints* released by EFRAG is not a checklist to identify material matters or IROs with, as it serves a different purpose. However, it can provide a useful inventory of the range of the sustainability matters covered by the ESRS topical standards at a more granular level (for example, metrics) than ESRS 1 paragraph AR 16.

76. Ultimately, for each identified material IRO that is reported, the undertaking shall disclose whether it relates to either own operations and/or upstream or downstream value chain as well as the relevant time horizon for potential impacts and risks and opportunities, as per ESRS 1 Chapter 6.4 *Definition of short-, medium- and long-term for reporting purposes*.

Approaches

77. The process of identification of the potential matters may start with the screening of the list of matters summarised in ESRS 1 paragraph AR 16 and then be complemented with additional entity-specific matters. These may follow from either internal processes (e.g., due diligence, risk management or grievance mechanisms) or external sources, such as those described in paragraph 70 above and stakeholder engagement.

78. The undertaking may also develop a 'long' list of impacts, risks and opportunities relevant to its business model and upstream/downstream value chain and aggregate them following the structure provided in ESRS 1 paragraph AR 16. The approach detailed in paragraph 77 above could be effective for undertakings new to preparing the sustainability statement. Alternatively, an undertaking could start from the matters as informed by existing processes (e.g., GRI reporting or internal processes such as due diligence and risk management). Then, the undertaking could compare the matters identified with the list in ESRS 1 AR 16 for completeness. The two approaches may be combined.

79. Regardless of the approach chosen to identify material sustainability matters, the purpose is to connect them to the corresponding IROs.

80. The undertaking may aggregate or disaggregate the IROs at the most appropriate level according to its facts and circumstances. It should relate the names it uses (or used before ESRS implementation) for sustainability matters when these differ from the list in ESRS 1 AR 16.

81. Chapter 5.5 *FAQ on aggregation/disaggregation* provides further guidance on aggregation/disaggregation.

3.3 Step C: Assessment and determination of material IROs related to sustainability matters

82. In this step, the undertaking applies criteria for assessing impact and financial materiality in order to determine the material actual and potential impacts and the material risks and opportunities. This then forms the basis for determining material information based on the ESRS topical disclosure requirements.

83. In ESRS 1 and ESRS 2, emphasis is being placed on setting appropriate qualitative or quantitative thresholds to assess the materiality of IROs and related disclosures. In particular, ESRS 2 paragraphs 53 and 59 require disclosing how these thresholds have been set or applied.

3.3.1 Impact materiality assessment

84. ESRS 1 Chapter 3.4 requires that undertakings apply objective criteria, using appropriate quantitative and/or qualitative thresholds to assess the materiality of actual and potential impacts. This is based on severity and, for potential impacts, also likelihood (see Chapter 3.6 *Deep dive into impact materiality – Setting thresholds*).

85. Therefore, the undertaking has to apply the criteria for severity to the list of impacts defined in step B above. The criteria are scale, scope and irremediable character of the impact for actual negative impacts. For potential negative impacts, the undertaking estimates also the likelihood of the impact occurring and maps it onto the relevant time horizon. For actual positive impacts, the criteria are scale and scope, and for potential positive impacts, the undertaking shall also estimate the likelihood of occurrence and map it onto the relevant time horizon.

86. Depending on the kind of impact, it may not always be necessary to assess in depth each of the criteria of severity, based on the undertaking's specific facts and circumstances, to determine whether the impact is material or not. For example, when there is an established scientific consensus about the severity of a particular kind of global or localised environmental impact, the undertaking can conclude that it is indeed material without having conducted an in-depth analysis of its scale, scope and irremediability. Therefore, the undertaking shall exercise judgement, informed by the available evidence, to determine what the appropriate level of the assessment of the severity criteria is.

87. The purpose of engagement with key affected stakeholders (including workers and their representatives) is to help the undertaking understand how they may be impacted, and therefore, it may help the undertaking assess the severity and likelihood of impacts[4]. Internal engagement with the undertaking's business functions and employees on the one hand and external engagement with users of sustainability reporting and other experts on the

[4] Consultation with affected stakeholders helps the undertaking understand how they may be impacted as part of the materiality assessment (refer to ESRS 2 IRO-1 paragraph 53 (b)(iii)). The outcome of the materiality assessment (i.e., ESRS 2 SBM 3 paragraph 48) requires the undertaking to disclose actual and potential impacts; potential impacts are defined as impacts that are likely to affect people or the environment.

other may also help to assess, validate and ensure the completeness of the outcome of the materiality assessment (see ESRS 1 paragraph AR8).

88. Chapter 3.5 Role and approach to stakeholders in the materiality assessment process and Chapter 3.6 Deep dive into impact materiality – Setting thresholds provide detailed guidance on the application of impact materiality criteria and thresholds. The responses to the FAQs on impact materiality in Chapter 5.1 provide further guidance on this matter. See also Chapter 4.3 Leveraging international instruments of due diligence.

3.3.2 Financial materiality assessment

89. Material risks and opportunities for the undertaking generally derive from impacts, dependencies or other factors, such as exposure to climate hazards or changes in regulation that address systemic risks. To assess their materiality, appropriate quantitative and/or qualitative thresholds based upon financial effects in terms of performance, financial position, cash flows and access to and cost of capital are used.

90. Sustainability risks and opportunities are assessed based on their likelihood of occurrence and the potential magnitude of their financial effects in the short-, medium- and long-term. Therefore, the undertaking is required to go through the list of potential material risks and opportunities in step B above and apply a set of objective thresholds for likelihood and magnitude as well as consider the nature of the effects of the identified risks and opportunities.

91. As most impacts give rise to financial risks and opportunities, the undertaking generally will assess whether material financial effects derive from the identified impacts (including the outcome of step B).

92. When applicable, the undertaking may compare the material risks and opportunities per the list prepared in step B to the ones used in its risk management process (for example, ERM[5] processes). However, this is only when the latter also covers sustainability risks. In such a case, the likelihood of the risks and opportunities, or their related financial effects, could be estimated accordingly.

93. It may be appropriate to engage with the undertaking's business functions as well as with investors of the undertaking and other financial counterparties (e.g., banks) to assess, validate and ensure the completeness of the list of material risks and opportunities.

94. Once a matter has been assessed to be material from a financial perspective, the undertaking determines the information to be reported based on its materiality (see Chapter 2.3 *Criteria to determine the materiality of information*). Information is considered financially material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general-purpose financial reports take on the basis of the undertaking's sustainability statement relating to providing resources to the undertaking.

[5] WBCSD. (2018). *Enterprise Risk Management*. Retrieved 31 May 2024 from https://docs.wbcsd.org/2018/10/COSO_WBCSD_ESGERM_Guidance.pdf

95. While the terms 'risks' and 'opportunities' are combined in the ESRS, depending on the specific circumstances there are matters that trigger exposure to risks only, others that trigger exposure to opportunities only and others that trigger exposure to both.

96. Responses to FAQs on financial materiality in Chapter 5.2 and Chapter 3.7 *Deep dive on financial materiality – Setting thresholds* provide further guidance on financial materiality.

3.3.3 Consolidating impact and financial materiality outcomes, including their interaction

97. This step consolidates the results of the previous steps and obtains the list of material IROs, which forms the basis for the preparation of the sustainability statement. Analysis performed at material topic/subtopic or sub-subtopic level is to be converted to IROs if this has not been done yet.

98. Once the undertaking has assessed individual IROs based on appropriate thresholds and methodologies, it may aggregate the resulting IROs for reporting purposes (refer to ESRS 1 paragraph 56). Those in charge of this activity may also validate the aggregated double materiality results with management to assess and validate the completeness of the list of material IROs.

3.4 Step D: Reporting

99. Following the materiality assessment process, the undertaking shall report on the assessment process and its outcome based on:

    (a) ESRS 2 IRO-1 Description of the processes to identify and assess material impacts, risks and opportunities;

    (b) ESRS 2 SBM-3 Material impacts, risks and opportunities and their interaction with strategy and business model; and

    (c) ESRS 2 IRO-2 *Disclosure requirements in ESRS covered by the undertaking's sustainability statement*. The undertaking shall also disclose how it has determined the material information to be disclosed, including thresholds and criteria used to assess such information (ESRS 2 paragraph 59).

100. In addition, ESRS 2 GOV-2 Information provided to and sustainability matters addressed by the undertaking's administrative, management and supervisory (AMB) bodies includes datapoints regarding how the AMB bodies are informed about the material impacts, risks and opportunities (ESRS 2 paragraph 26(a) considers the IROs when overseeing the undertaking's strategy and risk management process and how these material IROs have been addressed during the period. Chapter 5.6 FAQ on reporting provides further guidance on reporting.

3.5 Role and approach to stakeholders in the materiality assessment process

101. Stakeholders are classified into the following two groups: affected stakeholders and users of the sustainability statement[6] (ESRS 1 paragraph 22). Some, but not all, stakeholders may belong to both groups (ESRS 1 paragraph 23).

102. ESRS 2 requires transparency on the undertaking's consultation with affected stakeholders (IRO-1 paragraph 53 (b)(iii)). Even though the ESRS do not mandate behaviour, the undertaking is required to disclose whether and how the materiality assessment process identifies and assesses its impacts, including consultation with affected stakeholders, to understand how they may be impacted.

103. The outcome of the undertaking's ongoing due diligence processes that are in place is generally useful to inform the materiality assessment. However, the ESRS do not impose due diligence processes for the purposes of reporting only.

104. In particular, the ESRS clarify that the materiality assessment process is informed by the due diligence process, per the international due diligence instruments. These are the OECD Guidelines for Multinational Enterprises (MNE Guidelines) and the UN Guiding Principles on Business and Human Rights (UNGPs). The engagement with affected stakeholders is central to the undertaking's due diligence and impact assessment (ESRS 1 paragraph 24). The undertaking may engage with affected stakeholders or experts to provide input or feedback on the conclusions of the materiality assessment (ESRS 1 AR 8). Such engagement may provide evidence or insights into actual or potential impacts on people and the environment connected to the undertaking. Social dialogue with workers' representatives at the undertaking level is regulated at both European Union and national levels. Under the Accounting Directive 2013/34/EU (as amended by the CSRD), Member States have to require undertakings to inform the workers' representatives about sustainability reporting and to discuss with them the relevant information and the means of obtaining and verifying it.

105. Engagement – for example, consulting with affected stakeholders and incorporating their views into the materiality assessment – helps to substantiate their perspectives when determining the relevance of sustainability matters to them. For example, this includes engaging with the undertaking's employees and/or their representatives on health and safety matters. Such engagement also includes feedback received from affected

[6] Stakeholders are those who can affect or be affected by the undertaking. There are two main groups of stakeholders:
(a) 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; and
(b) users of sustainability statements: primary users of general-purpose financial reporting (existing and potential investors such as lenders and other creditors, including asset managers, credit institutions and insurance undertakings) and other users of sustainability statements, including the undertaking's business partners, trade unions and social partners, civil society and non-governmental organisations, governments, analysts and academics.

stakeholders from ongoing processes of engagement as part of the undertaking's business practices.

106. When performing the materiality assessment, an undertaking may leverage on its regular dialogue with affected stakeholders or may reach out to stakeholders specifically in the context of its reporting process.

107. Dialogue with affected stakeholders may assist during various steps of the materiality assessment. However, separate engagement with affected stakeholders in each step of the materiality assessment is not necessary, as undertakings may already have ongoing engagement with them to use. As mentioned in paragraph 69 of step A, the mapping of affected stakeholders and, where possible, prioritising them could be the first step. As part of step B, the undertaking may engage with them or build on past or ongoing engagement to map the impacts that they experience. Finally, in step C the undertaking may involve affected stakeholders in the assessment of the severity and likelihood of negative impacts that are relevant for them as well as, for example, in the case of particularly severe impacts in validating or providing feedback on impacts that have been assessed by the undertaking as material (refer to ESRS 1 paragraph AR 8).

108. In situations where engagement with affected stakeholders is not possible (for instance, because such engagement would put them at risk), the undertaking may consider appropriate alternatives. This may include consulting credible independent experts (ESRS S3 *Affected communities),* a Non-Governmental Organisation (NGO) representing this affected community, or for environmental matters, scientific articles and reports.

109. A source for impact materiality is scientific research, particularly for environmental matters, where credible scientific reports and other sources may be key to objectively assess the severity and/or likelihood of impacts.

110. Chapter 5.4 *FAQ on stakeholder engagement* provides further guidance on this matter.

3.5.1 Financial materiality considerations

111. Besides the abovementioned activities on impact materiality, engagement with users may also corroborate the evidence that supports financial materiality of sustainability matters and help companies assess financial materiality. The conclusions of the ESRS financial materiality assessment should be based on supportable evidence; this may include the views and interests of users. This is aligned with current practice for the financial reporting materiality processes, where notes to the financial statements and presentations to investors are adjusted regularly to reflect emerging issues and other matters of interest to investors. To this extent, the undertaking may leverage existing mechanisms of dialogue with shareholders, other investors and, in some cases, lenders to support its financial materiality assessment process.

112. In its approach to dialogue with users of sustainability information, the undertaking may consider stakeholders other than investors who may also be interested in general-purpose sustainability-related financial information; as such, information may be useful to assess how the undertaking manages its material impacts.

3.6 Deep dive into impact materiality – Setting thresholds

113. This section illustrates in more detail the methodologies or criteria that could be used for step C on impact materiality. An undertaking shall apply the relevant criteria using appropriate quantitative and/or qualitative thresholds to assess the materiality of impacts connected to its activities as well as those directly linked to its operations, products and services, including through the upstream and downstream value chain (ESRS 1 paragraph 42 and Chapter 3.4). However, ESRS 1 does not prescribe how to set thresholds.

114. ESRS 1 Chapter 3.4 clarifies that, for actual and negative impacts, materiality is based on the severity of the impact, while for positive impacts, materiality is based on the scale and scope. For potential impacts, materiality also includes consideration of their likelihood.

115. The severity of an actual or potential negative impact is assessed from the perspective of the affected people or the environment, and it is determined by the following characteristics that inform the basis for determining the thresholds:

    (a) **Scale**: how grave the impact is (i.e., extent of infringement of access to basic life necessities or freedoms such as education, livelihood, etc.);

    (b) **Scope**: how widespread the impact is (i.e., the number of individuals affected or the extent of the environmental damage); and

    (c) **Irremediable character**: the extent to which the impact can be remediated (e.g., through compensation or restitution, whether the people affected can be restored to their exercise of the right in question, etc.). The underlying question is whether there are any limits to the ability of restoring the environment or those affected to a situation at least the same as, or equivalent to, their situation, before the negative impact.

116. As discussed above, the undertaking may use its ongoing due diligence processes or other risk management processes to inform its threshold-setting and determine whether impacts are material for reporting purposes. In those processes, the undertaking's management of negative impacts is driven by an analysis of severity and/or risk prioritisation, which may inform the assessment of impact materiality.

117. When setting up thresholds, priority should be given to any supportable evidence that provides as much objectivity as possible to the materiality conclusion. However, reasonable quantification of the potential impacts may not always be possible to support the materiality assessment.

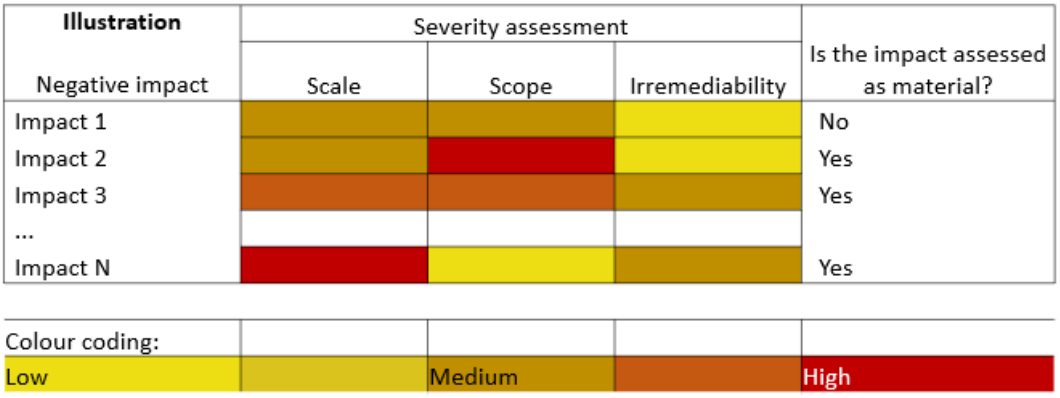
118. Any of the three characteristics of severity can make an impact severe, but often the characteristics are interdependent. Irremediable character could impact severity by increasing its scale. In turn, it is often the case that the greater the scale or the wider the scope of an impact, the harder it is to remediate, albeit a case-by-case assessment is to be performed in order to conclude if any of the three characteristics can make the impact severe.

3.6.1 Actual impacts

119. In the application of the concepts described above, **by way of illustration** an undertaking could map its actual impacts onto the three characteristics of severity in columns (figure 4) and could follow the criteria below, which is aligned with paragraph 116 above.

Figure 4: Graphical representation of impact severity for actual impacts in columnar format

Please note that that the graphical representation in this figure serves only as illustration of a possible approach to visualisation of the conclusions of assessment of impact materiality criteria. ESRS 2 IRO-1 also requires the undertaking to explain how it determined the materiality of the impact, including the qualitative and quantitative thresholds used.



3.6.2 Potential impacts

120. For potential impacts, likelihood is to be considered together with the severity of the impacts. However, in the case of human rights impacts, as specified in ESRS 1 paragraph 45, severity takes precedence over likelihood when identifying material matters.

121. By following the illustration above, the methodology would be the same and the likelihood dimension would be added. To this extent, and to simplify its representation, the three factors within severity would be combined along the severity axis, and likelihood of occurrence would be represented along the horizontal axis.

122. In terms of likelihood, the likelihood of a potential negative impact refers to the probability of the impact happening. The likelihood of an impact can be measured or determined qualitatively or quantitatively depending on the available information. It could be described by using general terms (e.g., 'unlikely', 'highly likely'), mathematically by using statistics terms (e.g., '10 in 100', '10 per cent') or by using frequency over a given time-period (e.g., 'once every 10 years').

Example on pollution

Undertaking A has a material pollution matter regarding a river next to its factory due to its scale and irremediable character. In the following year, A is acquired by group B.

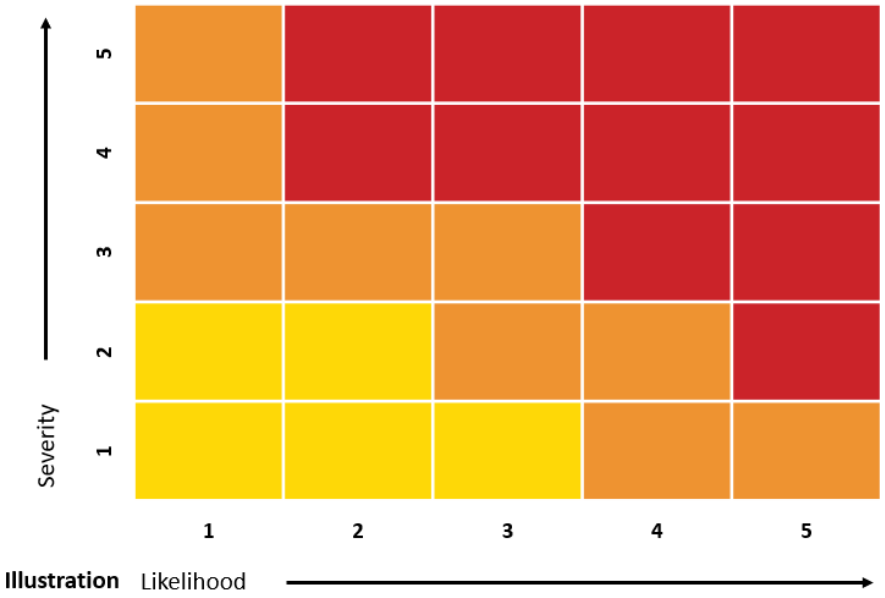
The scale of the impact of the pollution in the river to A is not affected by the fact that group B has several subsidiaries with other material environmental matters, some of them classified as medium on scale but higher in scope, as it affects a higher number of factories.

Therefore, the fact that an undertaking is acquired and forms part of a group does not change the severity categorisation of scale or irremediable character. Refer to section 3.6.3 for the consolidated materiality assessment approach.

123. A similar approach to the actual impacts could be applied whereby the threshold for reporting material impacts is defined as the red area in the illustrative graph below. In this illustrative example, the undertaking has assessed that high severity (scale 5) and low likelihood (scale 1) of negative impacts are material for environmental matters; such a decision is based on the undertaking's judgement. Impacts with very low probability may or may not be material depending on their severity if they occur. In the illustration provided in Figure 5, it is assumed that an impact with the lowest level of likelihood could be assessed to pertain to the highest level of materiality, as it would have catastrophic environmental consequences related to environmental hazards.

Figure 5: Thresholds for materiality of potential impacts for illustrative purposes only (the colour coding of the matrix is to be determined by each undertaking following the criteria in ESRS 1 Chapter 3.4 *Impact materiality*)

Please note that that the graphical representation in this figure serves only as illustration of a possible approach to visualisation of the conclusions of assessment of impact materiality criteria. ESRS 2 IRO-1 also requires the undertaking to explain how it determined the materiality of the impact, including the qualitative and quantitative thresholds used.



3.6.3 Consideration for groups and subsidiaries

124. ESRS 1 Chapter 7.6 *Consolidated reporting and subsidiary exemptions* states that the 'undertakings reporting at consolidated level shall ensure that all subsidiaries are covered in a way that allows for unbiased identification of material impacts, risks and opportunities' (ESRS 1 paragraph 102).

125. When performing the materiality assessment at a group level, paragraph 103 does not require the adoption for a given sustainability matter of a common threshold that is the same for the group in its entirety but rather to adopt an approach that is at the same time consistent across the whole group and unbiased, i.e., able to capture the specificities that may exist in a specific subsidiary. The response to FAQ 13 describes the top-down and bottom-up group materiality approaches. However, there is also a hybrid option whereby the starting point is to identify those impacts that are common across the group (for example, those related to ESRS E1 Climate change and ESRS S1 Own workforce), and then the bottom-up approach for impacts that are specific to one or more subsidiaries are assessed using the thresholds for the materiality assessment at group level (for more on this, refer to the disaggregation concept referenced in ESRS 1 paragraph 104 and described in section 3.7 *Level of disaggregation*).

126. The example on pollution above illustrates the interplay between materiality at a group level and the impacts that are specific to one subsidiary and not widespread across the group. The severity of a given impact will not change regardless of whether there is a bottom-up or a top-down approach.

127. In a group, a matter may be assessed as material as a result of the aggregation of several impacts derived from different subsidiaries that, if assessed in isolation by each subsidiary, would not be considered material. This is the case where aggregation of the impacts of the same nature across sites or subsidiaries is feasible and meaningful (for example, for environmental matters such as GHG emissions, emissions of pollutants or raw materials for circular economy). In other cases, when negative human rights impacts are occurring in the operations of just one subsidiary within a large corporate group, because the impacts are linked to the country's context, the impacts may still be so severe that they meet the group materiality threshold. This is consistent with ESRS 1 paragraph 55, which states that disaggregation by subsidiary may be necessary (refer to FAQ 13 *Performing the impact materiality assessment when the undertaking operates in different sectors*).

128. Conversely, in addition to disclosing information about matters that are material for the group in its entirety, there may be situations where a matter is assessed to be material for some subsidiaries in isolation but, despite the aggregation of data of such subsidiaries, the matter is assessed as not material for the group in its entirety. In this case following ESRS 1 paragraph 103, the undertaking would provide information about this material matter, in order to provide an adequate understanding of the specific impacts, risks and opportunities of the subsidiaries concerned. In this way, despite the absence of a reporting at subsidiary level due to the application of the subsidiary exemption, an appropriate level of transparency is preserved where the reporting undertaking identifies *significant differences between the IROs of the group and the IROs of one or more of its subsidiary undertakings (refer to CSRD article 29 a, 4)*. This could include, next to other relevant narrative information, metrics covering the amounts of those subsidiaries only. In this case contextual information would be helpful, to support the understanding that despite being material for one or more subsidiaries, the matter is not material for the group in its entirety and of which the entities are included in the disclosures, including in the metrics.

129. Therefore, there is no one single solution to assess the various impacts that arise from one or more subsidiaries across the group when defining the group thresholds and weighing the relevance of a particular subsidiary or group of subsidiaries, as we have illustrated for environmental and social matters above. Different methodologies and, where appropriate, aggregation methods may be used depending on the nature of the impacts.

130. In relation to ESRS 1 paragraph 103, the significant differences between the subsidiaries and the group are linked to the business models and the aspects covered in ESRS 2 IRO-1 paragraph 53 (b)(i)(ii), which are activities, business relationships, geographies and other factors. Similarly, ESRS 1 paragraph 104 clarifies that significant differences have to be assessed considering circumstances such as different sectors and others relevant to the level of disaggregation (ESRS 1 paragraphs 54-57), which include differences among countries or among significant assets/sites. Hence, an undertaking that is a

conglomerate operating in different sectors with different subsidiaries in them may not be able to identify material widespread impacts spanning across the group but rather subsidiary-related material impacts that cannot be aggregated at a group level. Therefore, the thresholds used in the materiality assessment at group level are to be impartially designed to avoid excluding these material impacts at the subsidiary level. For an investment holding company, this would mean looking at the impacts that relate to the investments in different sectors.

3.7 Deep dive into financial materiality – Setting thresholds

131. The ESRS do not prescribe the use of a specific threshold definition for financial materiality. However, ESRS 1 paragraph AR 15 states: 'Once the undertaking has identified its risks and opportunities, it shall determine which of them are material for reporting. This shall be based on a combination of (i) the likelihood of occurrence and (ii) the potential magnitude of financial effects determined in the basis of appropriate thresholds. In this step it shall consider the contribution of those risks and opportunities to financial effects in the short-, medium- and long-term.'

132. The undertaking may refer to absolute monetary thresholds or to relative monetary thresholds such as a percentage of the amount corresponding to a line item of its primary financial statements, its revenues, costs, total assets or net equity. Similar approaches to assessing the materiality of an item for the preparation of financial statements are in practice and may be a source of inspiration. However, the undertaking shall consider that the time horizon for financial materiality assessment in sustainability reporting is longer than the typical time horizon factored in financial statements and management commentary. This may result in the need to consider the cumulative effect of a sustainability matter on revenues, costs, etc., over a lengthy period of time. Similarly, a threshold for likelihood needs to consider the cumulative probability over a period of time to cover the long-term horizon as well.

133. In this context, the materiality assessment cannot be limited to the scope of financial effects that affect (or will affect at some point in the future) items recognised in the financial statements. The undertaking shall also consider financial effects associated with dependencies on natural and social resources that do not (yet) meet the criteria for accounting recognition (ESRS 1 paragraph AR 14 and AR 15).

134. The undertaking should also consider that a sustainability matter may be financially material despite its financial effects not being (reliably) measurable at the reporting date. In this case, the thresholds will rely on qualitative factors and ranges of possible effects (high/medium/low) – as in financial reporting, where materiality is not confined to quantitative aspects, but a transaction may be material due to its nature (i.e., qualitative approach to materiality). In addition, it should also be noted that the phase-in disclosures for anticipated financial effects apply as per ESRS 1 Appendix C ESRS 2 SBM-3.

135. With reference to the qualitative approach to materiality, there are circumstances in which, depending on the sector the undertaking is active in or the characteristics of its business model or operations, the undertaking is exposed to reputational risks that are of interest to investors. In this case, while

an effect on cash flows cannot be quantified, the reputational risk may influence the availability of finance and/or cost of funding and, therefore, may be financially material.

136. When the undertaking has mechanisms of dialogue with its shareholders, investors and lenders in place, it may leverage from this ongoing dialogue to corroborate the determination of its materiality threshold(s) in the context of financial materiality; The purpose is to report on information that, if omitted, misstated or obscured, could reasonably be expected to influence the decisions that those stakeholders make based on its sustainability statement (ESRS 1 paragraph 48).

137. As many sustainability matters that generate material impacts are also sources of material risks and opportunities, the undertaking shall carefully consider the linkages in its financial materiality assessment (refer to Chapter 3 Step B and Step C).

4. How can other sources be leveraged?[7]

4.1 Leveraging the GRI Standards

138. An assessment performed under the GRI is focussed on impact materiality but not on the financial materiality dimension, as the GRI is not based on double materiality the way the ESRS are (see Chapter 2.1 *Implementing the concept of double materiality*). However, the impact dimension is the same under GRI Universal Standards and the ESRS even if the scope of environmental, social and governance matters under the GRI may not be exactly the same as that of the ESRS. Therefore, an assessment performed under GRI Universal Standards constitutes a good basis for the assessment of impacts under the ESRS. The financial materiality dimension is to be added when moving from the GRI Universal Standards reporting framework to that of the ESRS.

139. Several synergies exist for undertakings that are currently reporting under the GRI Universal Standards 2021 framework in terms of:

    (a) the impact materiality assessment process: ESRS 1 Chapter 3.3, ESRS 2 IRO-1 and IRO-2 are aligned in substance with GRI Universal Standards, and the GRI materiality assessment can be the starting point for the ESRS double materiality assessment, with appropriate integration of financial materiality;

    (b) the universe of potential impacts identified using the GRI Universal Standards, which are compatible in principle with the list of matters in ESRS 1 paragraph AR 16 (and therefore also with ESRS architecture). In addition, a GRI materiality assessment can inform the process of identifying the entity-specific impacts; and

    (c) the role of due diligence and stakeholder engagement, which is central to both frameworks in informing the impact materiality assessment.

[7] The content of this chapter reflects the views of EFRAG but has not been validated by the GRI or by the ISSB.

4.2 Leveraging the ISSB Standards

140. As far as EFRAG's intentions and expectations are concerned, the criteria for financial materiality and materiality of information in the ESRS and the corresponding materiality approach in IFRS S1 are aligned. The following paragraphs illustrate this alignment.

141. The financial materiality assessment in ESRS 1 corresponds to the identification of information needed by primary users of general-purpose financial reports when making decisions relating to the provision of resources to the undertaking (ESRS 1 paragraph 48, aligned with IFRS S1 paragraph 1). Between the two standards, the definition of financial materiality is aligned[8].

142. Because the criteria for financial materiality in the two frameworks are aligned, an undertaking that applies the ESRS is expected to comply with the identification of the risks and opportunities under IFRS using the outcome of its ESRS assessment of financial materiality. In other words, the same financial materiality assessment process can support the identification of the risks and opportunities for both IFRS and ESRS purposes.

143. The general criterion for assessing the materiality of information and therefore to support the identification of the information to be reported (ESRS 1 paragraph 31) is expected, in most cases, to rely on decision-usefulness (see Chapter 2.3 *Criteria to determine the materiality of information*); this is also the criterion used in IFRS S1 to identify the information to be reported (as material). While in the ESRS the assessment of what is decision-useful considers both investors and other stakeholders, in IFRS this is limited to the users' needs for investors. However, the financial materiality dimension of the ESRS is focused on investors and, therefore, is also aligned with IFRS S1. This is compatible with the general principle of double materiality, as the information dataset that serves the needs of investors (financial materiality) is expected to be the same that fulfils the potential outside-in[9] information needs of other users (trade unions, academics, etc). The following examples illustrate this concept.

    (a) Affected communities may be interested in whether the provisions set aside to rehabilitate polluted production sites are sufficient to cover the necessary rehabilitation activities.

[8] For both IFRS S1 and ESRS 1, information is considered material for primary users of general-purpose financial reports if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the undertaking's sustainability statement (ESRS) or the undertaking's sustainability-related financial disclosures and sustainability statements (IFRS S1). In addition, IFRS S1 requires to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short-, medium- or long-term. Under ESRS 2 SBM-3, the undertaking shall disclose its material impacts, risks and opportunities. Under ESRS 1, 'A sustainability matter is material from a financial perspective if it generates risks or opportunities that have a material influence or could reasonably be expected to have a material influence, on the undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term' (ESRS 1 paragraph 49). To note: IFRS S1 does not use the term 'financial materiality' but 'materiality'.

[9] Information necessary to understand how sustainability matters affect the undertaking's development, performance and position.

(b) Current and prospective employees may want to learn about anticipated financial effects that could impact their prospects within the organisation (e.g., pensions or training).

144. Finally, IFRS S1 (paragraph 55) requires a reporting entity to refer to and consider the applicability of the disclosure topics in the SASB Standards. Similarly, following ESRS 1 AR 4 an undertaking shall consider IFRS Standards[10] as a source of possible entity-specific disclosure. In addition, ESRS 1 transitional provisions (paragraph 131 (b)) identify IFRS sector standards as a source of disclosure that an undertaking may use in the definition of its entity-specific disclosures in the absence of ESRS sector-specific standards. While for ESRS preparers the use of SASB standards is optional (as this is a possible source of disclosure but not the only one), the provision of entity-specific disclosure, including sector metrics, is a requirement (see ESRS 1 paragraph 11, AR 1 to AR 5).

4.3 Leveraging international instruments of due diligence

145. The materiality assessment of an undertaking's IROs is informed by the outcome of its due diligence process, when this is in place, as defined in the international instruments of the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises (refer to paragraph 102 of this Guidance).

146. The due diligence process includes steps to identify and assess negative impacts caused and contributed to by the undertaking as well as those connected to its own operations, products or services through its business relationships. This can be particularly useful when analysing the undertaking's upstream and downstream value chain and when identifying the impacts originating therein. Additionally, the due diligence instruments provide criteria for management to prioritise actions based on the severity and likelihood of the impacts previously identified.

147. In that sense, the due diligence process can help an undertaking both (a) to identify its negative actual and potential impacts (see step B in Chapter 3.2) and (b) to assess their materiality for reporting purposes based on the criteria of severity and likelihood (see step C in Chapter 3.3.1). The identification of material impacts also supports the identification of material sustainability risks and opportunities, which are often a consequence of such impacts.

148. Through this due diligence process, the undertaking can also identify affected stakeholders whose engagement informs the materiality assessment of IROs.

4.4 Leveraging other frameworks or sources

149. In addition to the other frameworks and international instruments mentioned above, EFRAG has worked together with the TNFD to issue a mapping between the TNFD 2024 framework and the related ESRS environmental disclosures, namely ESRS E3-E5. For the materiality assessment, the LEAP approach embedded within the TNFD disclosure framework may complement

[10] SASB standards are considered to be IFRS standard-setting material.

and support the identification of environmental matters (refer to ESRS E2 paragraph AR 1, ESRS E3 paragraph AR 1, ESRS E4 paragraph AR 6 and ESRS E5 AR 1).

150. Another input to use to identify IROs, along with other relevant ones in step B of the materiality assessment process (refer to ESRS 2 paragraph AR 2), could be the European standards approved by the European Standardisation System (ISO/IEC or CEN/CENELEC standards), which the undertakings may have applied (refer to ESRS 2 paragraph AR 2).

5. Frequently asked questions (FAQs)

5.1 FAQs on impact materiality

FAQ 1: Is impact materiality based on materiality for the undertaking or for stakeholders?

151. Impact materiality is based on its impact on people or the environment, which are in turn affected stakeholders for the undertaking.

152. The scope of impact materiality includes impacts on people and/or the environment connected to the undertaking's own operations and upstream and downstream value chain, including through its products and services as well as through its business relationships. For actual or potential impacts, the materiality is assessed by reference to the severity of such impacts on people and/or the environment. To assess impacts, stakeholder engagement is central as described in FAQ 16 *Do ESRS mandate to actively engage with stakeholders?*

153. In contrast, financial materiality focusses on the effects of sustainability matters on the undertaking's cash flows, financial performance and position, access to finance or cost of capital in the short-, medium- or long term, as such effects are material to the undertaking's investors.

154. When material impacts are also associated with material risks and opportunities, they are also material for the undertaking. However, impact materiality is assessed based on severity on people and the environment and not on the basis of the effects it has on the undertaking and its financial prospects.

FAQ 2: What is meant by the undertaking being 'connected' to an impact?

155. As explained above, impact materiality covers impacts connected to the undertaking's own operations and value chain, including through its products and services as well as through its business relationships. An undertaking can be connected to impacts in several ways as described below, according to the international due diligence instruments.

156. The undertaking may be single-handedly responsible for impacts to people or the environment if the **impacts are directly caused** by its operations, products or services. Examples of such cases include:

    (a) exposure of the undertaking's own workers to hazardous working conditions without adequate safety equipment;

(b) being the sole source of pollution in a community's drinking water supply due to chemical effluents from its production processes; and

(c) for a positive impact, an energy producer lowering the cost of renewable energy, allowing more customers to switch to renewable energy, thus contributing to mitigating climate change.

157. **Impacts to which the undertaking has contributed** are those not caused directly and solely by the undertaking's operations, products, or services but in conjunction with a third party. Therefore, any one action or omission from the undertaking does not single-handedly cause the impact but nevertheless does so with a third party's actions or omissions. For example, several factories locally release harmful emissions that are individually below harmful limits. However, together they affect the quality of the air in the local community, leading to a negative impact on the people and the environment.

158. Another example of contributing to an impact is when an undertaking facilitates or incentivises another party to cause or contribute to the impact, such as by changing requirements to suppliers repeatedly without adjusting production deadlines and prices, thus pushing suppliers to breach labour standards in order to deliver.

159. **Impacts directly linked to the undertaking's operations, products and services caused by a business relationship** are those in which the entity causing or contributing to the impact is linked to the undertaking through a business relationship. Business relationships are not limited to contractual relationships and partners with whom the undertaking directly interacts. They also include actors across the entire upstream/downstream value chain, including beyond the first tier – for example, a supplier subcontracting embroidery on clothing to child labourers, contrary to the contractual obligations.

160. The type of involvement (i.e., caused, contribute or directly linked) is important given that it could lead to a different approach when addressing the negative impacts. However, this does not imply that impacts that are directly linked are necessarily less material than those caused or contributed to, as the basis of the materiality assessment is severity.

FAQ 3: What are material IROs in the value chain?

161. See IG 2 FAQ 3: *How should the materiality assessment process be organised to properly capture material IROs that arise in the value chain?*

FAQ 4: Can positive impacts be netted against negative impacts?

162. No – impacts are to be assessed on their own, i.e., without taking into account other impacts. This means that positive impacts on the environment and people cannot be netted against negative impacts.

163. This is based on the following non-exhaustive list of principles:

(a) different nature of impacts: an undertaking shall not net positive impacts with negative impacts of a different nature (in the reporting year or in future years). This is consistent with ESRS 1 paragraph 56: '… The undertaking shall not aggregate material items that differ in

nature' as well as with the qualitative characteristics of information (QC 8 Appendix B of ESRS 1);

(b) timing of impacts: an undertaking shall not net actual negative/positive impacts in the reporting year with positive/negative impacts of the same nature in future years; and

(c) own operations or upstream/downstream value chain: an undertaking shall not net impacts in own operations with impacts in the upstream/downstream value chain.

164. Although netting and compensation/offsetting are different concepts, these are not allowed to be considered in the assessment of impact materiality. Specific requirements on topical standards for compensation/offsetting are included. ESRS E1 *Climate change* and ESRS E4 *Biodiversity and ecosystems* include specific requirements on how to report on carbon credits and biodiversity credits for material matters.

5.2 FAQs on financial materiality

FAQ 5: Is the material information for financial statements the same as for the sustainability statement?

165. No, it is not the same. However, the objective remains the same.

166. The financial materiality assessment of information depends on whether the information is considered to be material for the decision-making of those who provide, or may provide in the future, resources to the undertaking. The scope of financial materiality for the sustainability statement is an expansion of the scope of materiality used to determine the information to be included in the undertaking's financial statements (ESRS 1 paragraph 47). Whilst the concept of materiality does not differ between ESRS and financial reporting standards, the information that is likely to be material following the two sets of standards does. The principles applied for the preparation of the financial statements (under IFRS or local Generally Accepted Accounting Principles (GAAPs)), as illustrated by the financial reporting conceptual framework of IFRS, clearly delineate what should be accounted for on the basis of criteria for recognition of assets and liabilities as well income and expenses. As a result, when defining the thresholds for financial materiality used in the preparation of the sustainability statement, inspiration could be drawn from criteria and thresholds used in the preparation of the financial statements.

167. The differences between information that is likely to be financially material for the financial statements and information that is likely to be financially material for the sustainability statements relate to the following aspects.

(a) Sustainability reporting includes disclosures of anticipated financial effects of material risks or opportunities that are not captured or not yet fully captured by financial reporting at the reporting date. These could be reasonably expected to result in financial effects for the undertaking. Therefore, it is more likely that risks and opportunities that are not yet material for financial statements could be material for the sustainability statement, where there are different underlying principles to provide information on assets and liabilities (or on

resources/opportunities and risks before they meet the accounting definition of assets and liabilities).

(b) The information on the group is expanded in the sustainability statement to include information about material risks and opportunities arising from its business relationships, i.e., in the upstream/downstream value chain. Therefore, it is more likely that information about risks and opportunities arising from the undertaking's upstream/downstream value chain may be material for the sustainability statement but not be included in the financial statement.

(c) Potential future events may trigger current period disclosure about anticipated sustainability-related risks and opportunities in the sustainability statement, while financial statements typically account for risks based upon past events. Therefore, it is more likely that forward-looking information (such as anticipated financial effects) become material in the sustainability statement.

(d) Time horizons may be longer in sustainability reporting as it is not constrained by the horizons used in financial statements (such as useful lives of assets).

FAQ 6: Is financial materiality for sustainability reporting limited to effects presented in financial statements?

168. No – as described in FAQ 5 *Is the material information for financial statements the same as for the sustainability statements?* the basis for preparation and time horizons of financial and sustainability reporting differs. The concept of current and anticipated financial effects defined in Annex 2 of the Delegated Act distinguishes between:

(a) financial effects that have already crystallised and are recognised in the primary financial statements (i.e., current financial effects); and

(b) financial effects that do not meet the recognition criteria for inclusion in the financial statements in the reporting period (i.e., anticipated financial effects).

169. Reporting certain financial effects associated with material sustainability matters in the sustainability statement goes beyond what is required to be recognised and measured in the primary financial statements and disclosed in the notes to financial statements. In particular, financial effects that arise from risks and opportunities are to be reported, irrespective of their accounting treatment, when they have or could reasonably be expected to have a material influence on the undertaking's financial position, financial performance and cash flows over the short-, medium- and long- term. Sustainability risks or opportunities may derive from past or future events and may have financial effects in relation to:

(a) assets and liabilities already recognised in financial reporting. Potential adjustments to the carrying amount that are of interest for users of the sustainability statement may not meet the accounting criteria for recognition in financial statements at the reporting date albeit these anticipated financial effects are reported in the sustainability statement,

given their relevance to users. For example, these adjustments may include impairments that could arise as a result of a potential closure of plants in an area of water shortage;

(b) assets, liabilities, income and expenses that may only be recognised in financial reporting at a later stage but that are useful to users of the sustainability statement – for example, upcoming changes in the labour laws whereby platform workers are classified as employees with the right to the minimum wage and other social protection benefits, and the financial effects are reflected in future financial statements; and

(c) factors of value creation that do not meet the recognition criteria for the financial statements but that contribute to the generation of cash flows and the development of the undertaking. These may include internally generated intangibles, such as human capital, that could be described in sustainability reporting.

5.3 FAQs on the materiality assessment process

FAQ 7: How frequently should an undertaking update its sustainability materiality assessment?

170. The CSRD defines the frequency of sustainability reporting under the ESRS as annual given that the sustainability statement is part of the undertaking's management report. Accordingly, the undertaking is required to determine at each reporting date its material impacts, risks and opportunities as well as the material information to be included in the sustainability statement.

171. However, if the undertaking concludes based on appropriate evidence that the outcome of the prior reporting period's materiality assessment is still relevant at the reporting date, the preparation of the sustainability statement may use the conclusions previously reached. This may be true if the undertaking assesses that there have been no material changes in its organisational and operational structure of the undertaking and that there have been no material changes in the external factors that could generate new or modify existing IROs or that could impact the relevance of a specific disclosure. Examples of changed material facts and circumstances (i.e., triggers) could be:

(a) a major merger and acquisition transaction leading to a new activity, entering a new sector or a significant change in operations;

(b) a significant change of key suppliers or in the supply chain practices (including entering in a new geographical context with significant contextual risks, such as lack of adherence to human rights principles);

(c) a global event, such as a pandemic, or entering in a new material business relationship that is likely to have a severe impact on human rights;

(d) entering in a new market or starting a new line of business, or exiting an existing market and closing an existing line of business; and

(e) a shift in social conventions, scientific evidence or users' needs that could affect the characteristics of severity (e.g., the level of public

scrutiny significantly increases on a matter compared to previous periods or new studies, which provide evidence of the toxicity of a substance).

172. The analysis performed for the preparation of the sustainability statement for each reporting period should be sufficiently robust and proportionate to capture possible changes from the previous period(s), including in the value chain. The undertaking may do an annual update of its previous assessments, focusing on the impacts, risks and opportunities that are affected by the identified changes (e.g., as a result of the changes, some of them may cease to be material and other material impacts risks and opportunities may arise).

173. While it is possible to perform an annual update focused on the consequences of the identified changes, the materiality assessment is a dynamic process subject to the inherent evolution of the undertaking and needs to be considered for an update on an ongoing basis.

FAQ 8: May the undertaking consider only the sustainability matters in ESRS 1 AR 16?

174. No – ESRS 1 paragraph AR 16 states: 'Using this list is not a substitute for the process of determining material matters. This list is a tool to support the undertaking's materiality assessment. The undertaking still needs to consider its own specific circumstances when determining its material matters.' Some undertakings may have a list of material topics from previous impact materiality assessments (for instance, GRI Universal Standards reporting) and use the list from ESRS 1 paragraph AR 16, as described in step B of the Materiality assessment process, Chapter 3.2.

175. The list in ESRS paragraph AR 16 is a good starting point for the identification of sustainability matters, but it should not be used as a checklist substituting a materiality assessment. It is an inventory of the sustainability matters covered in the sector-agnostic topical ESRS. Sector-specific[11] and entity-specific sustainability matters (see ESRS 1 paragraph 11) should also be considered on top of this list.

176. Given that sector-specific ESRS have not been finalised yet, sector-specific sustainability matters shall be identified and assessed on an entity-specific basis until the sector standards are released (see ESRS 1 paragraph 131 (b)).

[11] Future sector specific ESRS will identify, where appropriate, additional sustainability matters.

FAQ 9: How to consider time horizon in the double materiality analysis?

177. A sustainability matter might be material from an impact or financial perspective over the short-, medium- or long-term. As such, time horizon is an essential component of the materiality assessment to be factored into the process. ESRS 1 paragraphs 77 to 81 define the standardised terms for time horizon, and they provide the option to select entity-specific horizons for the medium- and long-term.

178. In the double materiality analysis, the short-, medium- and long-term time horizons may be considered when assessing impacts, risks and opportunities:

    (a) for a proper ***understanding*** of the undertaking's facts and circumstances to set an appropriate time horizon based on the context of the undertaking;

    (b) for a proper ***identification*** of the list of sustainability matters, as the undertaking needs to reflect the entire time horizon (short-/medium-/long-term) to determine whether the IRO may occur or not; and

    (c) for the ***assessment*** of material matters, for which the undertaking may consider whether the financial effects linked to a material impact may crystalise in a different time horizon to another impact. Also, materiality thresholds might be affected by the time horizon.

Example on new regulation

A new regulation bans the use of microplastics within the production processes in the medium-term. The undertaking, using microplastics in its production, has identified a material risk from this issue in the short- and medium-term but not the long-term. The undertaking is adapting its production processes and investing ahead of the new regulation coming into effect.

Example on impaired assets

The financial effects of assets currently used that could become impaired in the long-term due to environmental changes could be not material as the assets will be fully amortised by the medium-term.

FAQ 10: Should the assessment of IROs rely on quantitative information?

179. Where possible, yes, as quantitative measures of IROs are objective evidence of their materiality. However, it is recognised that qualitative information is often valuable in informing the materiality assessment in its own right, including information from affected stakeholders. Qualitative information may provide relevant context for understanding quantitative measures.

180. The level of comfort sought by the undertaking from quantitative information depends on whether there is scientifically validated data and on consensus reached on the given impact. For example, global reports or industry information on a given topic, such as negative impacts on biodiversity loss, could provide the quantitative information needed without the need for the undertaking to incur in additional research or data collection costs.

181. Quantitative information is not always available or may result in additional costs. Whenever a qualitative analysis is sufficient for the undertaking to reasonably conclude that a matter is 'not material' or 'material', additional quantitative information would add no value to the materiality assessment. As the materiality assessment process evolves over time, the undertaking may redefine the balance between qualitative and quantitative information.

Example of severity

If the undertaking concludes, based on qualitative criteria, that an impact connected to the undertaking sits on the edge dividing what is material from what is non-material, it may consider quantitative information on severity (i.e., scale or scope) as described below to assess the materiality of the impacts. For example, it may consider:

1. the amount of water used in a particularly water-stressed area; or
2. the number of people possibly affected in a community where it has a production site.

182. Quantitative information would, however, be of interest where a topic is in between being material and non-material based on qualitative information and/or where there are diverse views on it. In that case, quantification could corroborate the conclusion.

183. In this context, the undertaking may adopt measures of impacts inspired by the indicators in the Metrics and Targets section of the topical ESRS.

FAQ 11: Should the IRO dimensions of a sustainability matter be aggregated for the materiality assessment?

184. No – even if impact and financial materiality are interrelated and the interconnections among the two dimensions shall be considered (see ESRS 1 Chapter 3.3. *Double materiality*), a sustainability matter does not have to be material from both dimensions to be regarded as material for reporting purposes.

185. For example, an undertaking in the extractive industry has assessed health and safety as a material negative impact due to the frequency and severity of work-related accidents in its location. However, the current financial effects are not considered financially material. Therefore, the impacts, risks and opportunities on this matter are not aggregated, and the matter is regarded as material from an impact materiality dimension only.

FAQ 12: Should the materiality assessment be documented/evidenced?

186. The ESRS do not prescribe specific documentation as this is outside its remit, but it is reasonable to expect a certain level of documentation to be needed for internal purposes.

187. Such documentation could inform those in charge of the governance of the process of sustainability reporting (see ESRS 2 GOV- 2) so as to best prepare the ESRS 2 IRO-1 disclosures and help assurance providers to perform their work.

188. The CSRD modifies the Accounting Directive with respect to the definition of the content of the management report in relation to sustainability information and its digitisation (namely Art 19a and Art 29a) and has introduced mandatory

assurance of the sustainability statement (in particular, Art 34). The documentation requirements and level of evidence to support the materiality assessment (i.e., ESRS 2 IRO-1 and 2 as well as ESRS SBM-3) are not described in the ESRS.

FAQ 13: Performing the impact materiality assessment when the undertaking operates in different sectors

189. The ESRS do not prescribe a specific process for the materiality assessment as no one process fits all undertakings, including diversified global undertakings.

190. The parent undertaking (as defined in ESRS 1 Chapter 7.6) performs its materiality assessment for the consolidated group for the group's material impacts, risks and opportunities (according to CSRD Art. 29a) irrespective of its group legal structure and of the aggregation used to prepare the disclosures in the consolidated sustainability statement. Refer to section 3.6.3 of this implementation guidance to understand the conceptual framework and the example offered on pollution for a subsidiary.

191. The parent undertaking may perform its materiality assessment using different approaches or a combination of two. These two are:

    (a) **a top-down approach**, with an assessment performed at the group level while engaging or consulting with subsidiaries, including to receive the necessary information; and/or

    (b) **a bottom-up approach**, with an assessment performed at the subsidiary level and consolidating the results at the group level.

192. An undertaking may have a variety of sustainability matters from different subsidiaries where different levels of severity have been identified in performing its materiality assessment at the group level. For example, it may have a high severity impact from a small revenue stream and a medium severity impact from its main revenue stream. Therefore, in defining thresholds (see step C in chapter 3.3) the parent undertaking of a group operating in different sectors has to consider an appropriate level of consistency in methodologies when setting the appropriate thresholds across the entire group, keeping at the same time in consideration potential differences that exist in the exposure to impacts, risks and opportunities at the level of single subsidiaries where appropriate. For example, in a conglomerate that operates in different sectors, the materiality assessment conducted for each sector will have its own peculiarities. (refer to Chapter 3.7 *Deep dive into impact materiality - Setting thresholds*). Furthermore, the undertaking cannot simply aggregate different impacts across the various subsidiaries or sectors it operates in and apply a group threshold across all of them, as it risks obscuring the information. In some cases, the negative impacts cannot be aggregated, such as when they relate to high severity impacts like the violation of human rights, which are to be considered on an individual basis, i.e., at a subsidiary or country level (refer to ESRS 1 paragraph 103 and levels of disaggregation).

193. The undertaking should consider IROs or matters commonly associated with its sectors, geographic locations or a specific subsidiary (see Step A in Chapter 3.1). Here, the sector standards will help in identifying the impacts, risks and opportunities and in assessing them.

FAQ 14: Will the implementation of sector-specific standards create any new subtopics or sub-subtopics to be considered in the materiality assessment?

194. Yes, it may. The sector-specific standards will add another layer to the sector-agnostic standards and complement them in depth for a given subtopic/sub-subtopic or may increase the number of subtopics/sub-subtopics.

195. Both sets of standards will have a consistent architecture. The sector-specific standards will provide a list and description of sustainability matters common to the sector and build on ESRS 1 paragraph AR 16.

196. As a temporary measure before the adoption of the sector-specific standards, the undertaking may use the transitional provision related to entity-specific disclosures (see ESRS 1 chapter 10.1). This allows undertakings to carry forward their previous sustainability disclosures or to design additional disclosures using best practices or other frameworks (e.g., IFRS industry-based guidance or GRI's) for entity-specific disclosure (per ESRS 1 paragraph 11) as long as this information meets the qualitative characteristics of information laid out in ESRS 1 Appendix B. The transitional provision is applicable for the first three sustainability statements of the undertaking.

5.4 FAQs on stakeholder engagement - Impact materiality

FAQ 15: Do the ESRS mandate to actively engage in dialogue with affected stakeholders for the materiality assessment process?

197. The ESRS require disclosure on the materiality assessment and its outcomes but do not mandate specific behaviour on stakeholder engagement or the due diligence process.

198. However, ESRS 1 paragraph 45 states that the impact materiality assessment is informed by the undertaking's due diligence process. In addition, ESRS 1 paragraph 24 points to affected stakeholders' engagement as central to the materiality assessment. Engagement with affected stakeholders is a tool that supports the undertaking's business processes (for example, due diligence) as well as the management of sustainability matters. The undertaking, when preparing its sustainability statement, can leverage its engagement with affected stakeholders per its due diligence process, if applicable.

199. Stakeholder engagement informs the identification and assessment of material impacts. This can help the assessment of severity, likelihood and time horizons and also ensure the completeness of the material impacts identified. Refer to Chapter 3.5 *Role and approach to stakeholders in the materiality assessment*.

FAQ 16: Can the undertaking prioritise some categories of stakeholders for the materiality assessment process? How?

200. Engagement with affected stakeholders helps the undertaking to understand which sustainability matters are sources of concern for the respective stakeholders and how they are affected. This information may be useful input for the assessment. For further information, see Chapter 3.5 *Role and approach to stakeholders in the materiality assessment*.

201. ESRS 1 paragraph 22(a) states: 'affected stakeholders: the 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'. The concept of 'key stakeholders' (or 'relevant stakeholders', per international instruments) rests on the idea that not all stakeholders will be equally affected by the undertaking's activities. Furthermore, the undertaking is to identify which stakeholders' views are to be taken into account in connection with a specific activity. It also builds upon the idea that the degree of impact on stakeholders may inform the degree of engagement specifically for prioritisation.

202. The undertaking may consider engaging stakeholders or their representatives to determine whether they are affected or not if not obvious.

203. The undertaking may not engage with all the stakeholders for all sustainability matters. Engagement with stakeholders who are not affected by the specific sustainability matter is not meaningful. Therefore, the undertaking may engage with different groups of affected stakeholders for different matters.

FAQ 17: What is the role of silent stakeholders and how should they be considered?

204. There may be stakeholders who cannot voice their concerns, and in the ESRS nature has been identified as a silent stakeholder (ESRS 1 paragraph AR 7). Nature is an essential part of the sustainability context of the undertaking and the value chain it operates in. Nature, unlike other stakeholders, cannot voice its concerns on its own, neither verbally nor in writing. Data from scientific sources (e.g., scientific studies on the planetary boundaries or scientifically validated data) may give nature a voice as it may explain the state of nature, such as the health of bird populations, the state of water bodies or the condition of a forest.

205. Channels monitoring the concerns of silent stakeholders can provide valuable input to the materiality assessment for impacts, dependencies and, where applicable, the subsequent risks and opportunities for the undertaking.

206. Examples on considering silent stakeholders could include:

    (a) identifying the silent stakeholders likely to be impacted by the undertaking's activities and the actual and associated potential impacts of the undertaking;

    (b) research to understand the potential or actual impacts on these stakeholders, such as reviews of scientific studies, articles and environmental impact assessments. Such research can be at a global level (e.g., planetary boundaries for biodiversity) or at a local level (e.g., via its impact on stressed water bodies or by identifying the type of species impacted);

    (c) using proxies such as organisations that are legitimate representatives of, or that are considered by the undertaking to appropriately represent, the silent stakeholder. For considerations about nature, the undertaking may consider organisations that assess the current and future state of the ecosystem, water resources or climate; and

(d) testing the results of the estimated potential impacts based on experts' consultation, collaborative partnership with NGOs and other stakeholders.

5.5 FAQs on aggregation/disaggregation

FAQ 18: Does the undertaking use the same criteria when defining the level of disaggregation across all IROs?

207. No – the disaggregation for materiality purposes of the material impacts should fairly reflect the severity of actual impacts or the severity and likelihood of potential impacts and it may be different across the various material impacts. For risks and opportunities, it should reflect the magnitude of current financial effects, while for anticipated financial effects it should reflect the magnitude and likelihood. The principle is to avoid obscuring the specificity and context necessary to interpret the information and to avoid the aggregation of material items of a different nature. This is set out in ESRS 1 paragraph 54: 'When needed for a proper understanding of its material impacts, risks and opportunities, the undertaking shall disaggregate the reported information:

    (a) by country, when there are significant variations of material impacts, risks and opportunities across countries and when presenting the information at a higher level of aggregation (for instance, region) would obscure material information about impacts, risks or opportunities; or

    (b) by significant site or by significant asset, when material impacts, risks and opportunities are highly dependent on a specific location or asset rather than presenting the information at a higher level of aggregation (for instance, countries).'

208. ESRS 1 paragraph 55 clarifies that in defining the approach to disaggregation of reported information the undertaking shall, for consistency reasons, consider the approach adopted for materiality assessment.

Examples on disaggregation criteria

- When assessing the materiality of impacts relating to water usage, a criterion to be considered for disaggregation could be based on the vulnerability to water-stress by geographical area or, if appropriate, site.
- Child labour impacts whose severity can depend on country specific laws and regulations and labour market practices; therefore, country level disaggregation could be the criterion.
- An undertaking in the garment manufacturing industry has subsidiaries in different countries, and adequate wages and collective bargaining have not been considered material impacts overall. However, there is one country with heightened risk of negative impacts due to current working conditions that are well documented in UN human rights reports. The undertaking has subsidiaries with 15% of the group's workforce, who does pay below the adequate wages for the country, and collective bargaining agreements do not take place. The materiality assessment should consider the disaggregation at a country level to identify material negative impacts. Similar disaggregation might be considered for an undertaking that has production sites in different countries or regions for impacts related to pollution or doing business in countries where higher risks of corruption and bribery are observed compared

209. Where the severity of impacts could be obscured by aggregating data, the undertaking should disaggregate per country, site, asset or subsidiary to meet the qualitative characteristics of information, namely relevance and faithful representation. In this way, the undertaking would provide an accurate and truthful representation when disclosing the severity of the related impact. Disaggregation of data should focus on the specific facts and circumstances of the reporting undertaking. Hence, the undertaking could adopt a different level of disaggregation for two separate sustainability matters within the same topic (e.g., own workforce: adequate wages and training and development), and this would be appropriate depending on the circumstances.

210. For risks and opportunities, the focus is whether aggregation could obscure information that could influence the investor's decisions to provide funds to the undertaking.

211. As described in ESRS 1 paragraph 55, the disclosures in the sustainability statement shall consider the level of disaggregation adopted in the corresponding materiality assessment.

FAQ 19: Is an IFRS or local GAAP segment an appropriate level of disaggregation for the materiality assessment?

212. In general, no – the goals of the disaggregation objectives for financial reporting and sustainability reporting are different (also refer to FAQ 5: *Is the material information for financial statements the same as for the sustainability statement?* and FAQ 6: Is financial materiality for sustainability reporting limited to effects presented in financial statements?). In general, the sector classification of the undertaking's activities is more appropriate as a starting point (refer to ESRS 2 IRO-1 paragraph 53(b)(i)).

213. Segment reporting under IFRS is based on a 'management approach' (as explained in the *Basis for Conclusions* for ESRS 2). Local GAAP may be based on the same or a different approach for segment reporting. The core principle of IFRS 8 *Segment Reporting* is to require disclosures to enable users of the financial statements to evaluate the nature and financial effects of the business activities of the undertaking as well as the economic environments in which it operates (IFRS 8 paragraph 1). The level of disaggregation or reportable

segments in IFRS 8 are consistently applied in financial reporting without variation in the reported items.

Example

A multinational group that prepares consolidated accounts bases its segments of financial reporting on products and services offered worldwide.

When performing its sustainability materiality assessment on water, the undertaking determines that the material negative impacts are correlated with the levels of water stress in the geographical areas where the factories are located. Therefore, it determines that the disaggregation is to be performed at the geographical level and concludes that the financial reporting segments are not appropriate.

214. The disaggregation for financial reporting segments is designed for a different purpose and, in general, it is not expected to be the starting point to reflect material IROs across the components of the undertaking's operations. The appropriate disaggregation unit for IROs in the sustainability statement may be a country, site or significant asset when material impacts, risks and opportunities arise in a specific country, location or asset, respectively. In addition, the level of disaggregation should reflect the nature of the different subtopics and, as such, should be adjusted from one subtopic to another when this is necessary to properly portray the material IROs (see ESRS 1 paragraph 54). For more on this, refer to FAQ 18: *Does the undertaking use the same criteria when defining the level of disaggregation across all IROs?*

215. Therefore, a disaggregation following the segments used for financial reporting may not be granular enough or relevant enough for sustainability reporting purposes[12].

5.6 FAQs on reporting

FAQ 20: Do the ESRS require disclosure of severity for material impacts as well as likelihood and magnitude for material risks and opportunities?

216. The ESRS do not require disclosure of the detailed outcome per each criterion; however, an appropriate explanation of criteria and thresholds used shall be included. The undertaking shall report on the processes to identify and assess material IROs, as required by ESRS 2 IRO-1, and on the outcome, as required by ESRS 2 SBM-3 and IRO-2. ESRS 2 SBM-3 paragraph 48(g) requires disclosure on changes to the material IROs since the prior year. For instance, on impact materiality the scale and irremediable character of a particular negative impact could have been assessed as high in the current period versus medium in the prior year and thus become material and in need of disclosure.

217. As explained in FAQ 12 *Should the materiality assessment be documented/evidenced?* the ESRS do not prescribe specific documentation; however, it is reasonable to expect that a certain level of documentation will

[12] ESRS 1 SBM-1 requires the identification of the ESRS sectors in which the undertaking operates (ESRS 2 paragraph (b) and (c)) and requires disclosure of the revenues by ESRS sectors. According to the work programme approved by the EFRAG SRB on 11 October 2023, EFRAG will consult in the last quarter of 2024 on a proposed ESRS sector classification. However, the undertaking has to determine the necessary level of disaggregation of its disclosure following Chapter 3.7 of ESRS 1 and cannot assume that the ESRS sector disaggregation is appropriate for all the disclosures.

be produced. This could be used for internal purposes and for the assurance providers of the undertaking's sustainability statement.

218. Such documentation can also include a description of severity (including scale, scope and irremediable character) and likelihood of material impacts as well as likelihood of occurrence and potential magnitude of material risks and opportunities. This documentation can help the undertaking's management and the assurance provider (i.e., as audit evidence) to better understand the materiality assessment process and the related results.

FAQ 21: If a matter is material from the financial (or impact) perspective only, shall disclosures cover all the requirements or only information about the relevant perspective?

219. The determination of information to be reported for metrics is informed by the assessment of the materiality of information (refer to Chapter 2.3 *Criteria for the determination of the materiality of information*). Hence, if a matter is material due to its impacts and there are no material risks and opportunities arising from the same matter, information disclosed on metrics shall be limited to metrics that are relevant under the impact materiality perspective, and the datapoints related to the risks and opportunities or financial effects are to be omitted[13] (ESRS 1 paragraphs 31 and 34).

220. When a matter is assessed to be material from a financial (or impact) perspective only, the information about policies, actions and targets shall cover all the datapoints in the minimum disclosure requirements[14] and the topical standards (ESRS 1 paragraph 33). The level of detail of such information will reflect the general approach to information materiality (ESRS 1 paragraph 31) The undertaking will describe the content of policies, actions and targets in place connected to the sustainability matters that are material from the impact or financial perspectives or both, according to the materiality assessment.

221. It is also important to note that disclosure that informs about actual or potential impacts is of interest for investors when a matter is financially material. Similarly, financial information is also relevant for stakeholders other than investors when a matter is material from the impact perspective as it supports accountability.

FAQ 22: Is a multi-sector group required to include metrics for the entire group or only data related to the material IROs?

222. Once metrics have been assessed for materiality and determined to be material, the data for the entire group shall be included in the metrics. This is not the case where specified differently in sector-agnostic topical or sector-specific standards (refer to the example below).

[13] A datapoint of a Disclosure Requirement in metrics may be omitted when the corresponding information is assessed to be not material provided that the omitted information is not needed to meet the objective of the Disclosure Requirement (ESRS 1 paragraph 34).
[14] See ESRS 2 Chapter 4.2 *Minimum Disclosure Requirements on policies and actions* and Minimum Disclosure Requirements on targets in Chapter 5 *Metrics and targets*.

223. ESRS 1 stipulates that the sustainability statement shall be for the same reporting undertaking as the financial statements (ESRS 1 paragraph 62). If the undertaking prepares consolidated financial statements, the reporting entity is the entire group (i.e., the parent and its subsidiaries). For the assessment of material IROs, ESRS 1 clarifies that it is performed 'for the entire consolidated group, regardless of the group's legal structure' (ESRS 1 paragraph 102). The group's legal structure is also irrelevant for reporting on metrics, as the reporting should be the same whether an undertaking is conducting its business activities through multiple legal entities or does the same business activities using only one legal entity.

224. ESRS 1 paragraph 57 also stipulates that, 'When a topical or sector-specific ESRS requires that a specific level of disaggregation is adopted in preparing a specific item of information, the requirements in the topical or sector-specific ESRS shall prevail.' Therefore, undertakings can disaggregate the metric information further than providing it at a group level only when this is required by a topical standard or deemed relevant at the entity-specific level.

Example on ESRS E3

Assume that a group is active in sector A and B with two subsidiaries, A and B, respectively. The group has a material IRO in relation to water consumption. The IRO is only material for sector A, i.e., subsidiary A, however given the materiality of such IRO, the matter is considered material for the group in its entirety. ESRS E3-4 requires that:

a. the total water consumption in m^3 be disclosed for own operations – hence, for the entire group (ESRS E3 paragraph 28(a); also, per paragraph 28(c) the total, as well as per paragraph 28(d)); and

b. the total water consumption in areas at water risk (ESRS E3 paragraph 28(b)) be disclosed depending on whether the areas of water risks relate only to sector A or subsidiary A.

According to ESRS E3-1, the undertaking shall describe the policies it has adopted that address the management of its IROs related to water and marine resources. As water consumption is only material for sector A, subsidiary A may have appropriate policies, and the disclosure would cover these as relevant. Similarly, it would be appropriate to only disclose on actions and targets for sector A if actions are taken and targets are set at that level.

225. Disclosure regarding IRO management related to policies, actions and targets will reflect the extent of the activities within the group that are covered by those policies, actions and targets. As such, they may only cover the 'problem area' of the material IRO when appropriate. Likewise, for entity-specific metrics the metric could be focussed on the parts of the group where such material IROs arise.

226. Finally, the ESRS stipulate for the level of disaggregation that, 'when needed for a proper understanding of its material IROs, the undertaking shall disaggregate the reported information …' (ESRS 1 paragraph 54).

227. In addition to disclosing information about matters that are material for the group in its entirety, there may be situations where a matter is assessed to be material for some subsidiaries in isolation but, despite the aggregation of data of such subsidiaries, the matter is assessed as not material for the group in its entirety. In this case following paragraph 103 of ESRS 1, the undertaking would

provide information about this material matter, in order to provide an adequate understanding of the specific impacts, risks and opportunities of the subsidiaries concerned. In this way, despite the absence of a reporting at subsidiary level due to the application of the subsidiary exemption, an appropriate level of transparency is preserved where the reporting undertaking identifies *significant differences between the IROs of the group and the IROs of one or more of its subsidiary undertakings (refer to CSRD article 29 a, 4)*. This could include, next to other relevant narrative information, metrics covering the amounts of those subsidiaries only. In this case contextual information would be helpful, to support the understanding that despite being material for one or more subsidiaries, the matter is not material for the group in its entirety and the undertaking, as well as to disclose which entities are included in the disclosures, including in the metrics.

FAQ 23: Are remediation and mitigation actions considered in the materiality assessment of environmental impacts?

228. As a general principle, environmental impacts are considered before any mitigating actions in the materiality assessment. This is linked to the objective of providing information on the management of impacts by the undertaking over time, and it is mirrored in the ESRS architecture as follows for the potential impacts.

    (a) The description of the impacts before taking into account remediation, prevention or mitigation actions is the basis for the materiality assessment process and its related disclosures (namely, ESRS 2 IRO-1 and SBM-3).

    (b) The management of such impacts – including remediation, prevention and mitigation actions – is part of the policies, actions and targets (i.e., MDR-P, MDR-A and MDR-T).

    (c) The users of the sustainability statement will obtain an understanding of the unmitigated impacts connected to the undertaking and how the undertaking is addressing those – that is, an understanding of the impacts after remediation, mitigation and prevention.

229. Differentiating between actual impacts (i.e., those that have happened or are ongoing in the reporting period) and potential impacts (i.e., those that have a likelihood of occurrence in the short-, medium- or long-term) is relevant, and the illustrations below develop these concepts.

Actual impacts

230. The undertaking is expected to assess the actual impacts that have taken place in the current or previous reporting period(s). The severity of the impact, assessed for the current reporting period, depends on successful mitigation that has taken place before or during the event. This is further illustrated as follows.

    (a) For an accident occurred in the current year, such as an oil spill or the failure of an emission treatment facility and subsequent pollution-related impacts, the undertaking is expected to consider these events in its materiality assessment when identifying actual impacts. Any remediation or rehabilitation activities put in place after the event but

in the same period are not taken into account in the materiality assessment. Likewise, mitigation actions that the undertaking may carry out in the future are not taken into account in the materiality assessment. On the contrary, mitigation activities, such as pollution containment or immediate stopping of operations that were put in place before and during the incident, are considered when assessing the severity of the actual impact as they either worked or did not work to mitigate the impact or its severity.

(b) For material negative impacts that occurred in the past, these are expected to be considered in the materiality assessment as well as whether they are still considered material in the current reporting period. In the example of the oil spill, the aquatic and coastal ecosystems may be materially negatively affected by the oil pollution for many years and remain in the materiality assessment for a number of years.

Potential impacts

231. The undertaking is expected to assess its potential impacts and disclose those that are material. These potential impacts relate to both the existing operations and the planned operations; an example for planned operations is the construction of a new factory or a new production line in an existing factory.

232. The example below illustrates the preceding paragraphs.

(a) If a chemical producer plans to introduce a new production process using a hazardous substance without any available wastewater treatment technique, at the time of preparing the assessment it cannot assume in its materiality assessment that such a technique will be available in the future and neglect the potential impact.

233. Whilst similar concepts and questions apply to social impacts, guidance covering social impacts may be issued in the future to better reflect specific aspects of those matters.

FAQ 24: Shall the undertaking also report on material matters where there are no actions?

234. Yes – the materiality assessment is performed by the undertaking to identify the material IROs to be reported.

235. ESRS 1 paragraph 33 establishes that, for the material matter to be identified, the undertaking shall disclose its policies, actions and targets to manage IROs related to the matter. It also specifies that, if the undertaking has not implemented a policy, action or target, this fact is to be disclosed. The requirements of information to be disclosed for policies, actions and targets are detailed in ESRS 2 Chapter 4.2 and Chapter 5.

Example

A hotel has identified the lack of health and safety training as a material impact. However, it has no formal training policy or actions on this. Health and safety training is a material matter which is disclosed, along with the fact that there are no such policies or actions, at the end of the reporting year. The undertaking may disclose if it is working on drafting and implementing such policies and actions.

5.7 FAQ on Art. 8 EU Taxonomy

FAQ 25: What is the relationship between taxonomy eligible activities and materiality?

236. The EU Taxonomy Regulation and its Delegated Acts define criteria for a number of economic activities (eligible activities) that need to be fulfilled in order to substantially contribute to one of six environmental objectives. In addition, these activities must do no significant harm (DNSH) to the other environmental objectives and fulfil minimum social safeguards to be considered taxonomy aligned. The environmental objectives of the Taxonomy Regulation are fully reflected in the environmental topics covered by the ESRS. If an undertaking engages in activities that are eligible for the EU Taxonomy, this indicates that it impacts the environmental objective for which the Taxonomy defines substantial contribution (SC). To this extent, the following information can be an input to the materiality assessment when identifying IROs (i.e., refer to Chapter 3.2 Step B of this Guidance):

    (a) whether the undertaking has in place activities that do or do not comply with the criteria for substantial contribution, including Capex plans; and

    (b) whether these activities comply or not with one or more of the DNSH criteria.

237. Despite the relationship between the Art. 8 Taxonomy and ESRS, taxonomy-eligibility is no precedent for the ESRS materiality assessment. Reporting taxonomy-eligible activities by an undertaking neither oblige companies to assess those as material nor to explain that they are not. The Art. 8 Taxonomy is a process that can inform the materiality assessment; other processes that can also inform it are due diligence and the enterprise risk management.