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Implementation guidance for the materiality assessment

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Summary in 10 key points

1. The materiality assessment is the process by which the undertaking determines material matters and material information to be reported on in its sustainability statement. The performance of an objective materiality assessment is pivotal to sustainability reporting which shall include relevant and faithful information about all impacts, risks and opportunities (IROs) across environmental, social and governance matters determined to be material from the impact materiality perspective or the financial materiality perspective or both.
2. The assessment is not limited to the undertaking's own operations as it also includes its upstream and downstream value chain.
3. Once an impact, risk or opportunity have been identified as material, the undertaking (a) refers to the requirements in the related ESRS to identify the relevant information to be considered for disclosure on the matter or (b), when the impact, risk or opportunity is not covered or insufficiently covered by the ESRS, shall design a relevant entity-specific disclosure. Relevance is the criteria to support the identification of the information to be disclosed. Relevance is based on (a) the significance of the information in relation to the matter it depicts or (b) its decision-usefulness.
4. The determination of the information to be reported depends on whether the information relates to (a) policies, actions and targets; or (b) metrics. For policies, actions and targets, information shall be disclosed according to the Disclosure Requirements, or it shall be stated that the undertaking does not have policies, actions and/or targets. For metrics, it is possible to omit them when they are assessed as not material based on the materiality assessment. Such an omission is in itself useful sustainability-related information. Omitting datapoints derived from EU legislation based on materiality requires stating explicitly that they are not material. ESRS 2 Disclosure Requirements which address cross-cutting matters are to be reported on in all cases (irrespective of the outcome of the materiality assessment).
5. The materiality assessment process shall be designed to identify all material impacts, risks and opportunities and consequently also to exclude those that are not material. A materiality assessment that would meet the requirements of ESRS could include the following steps:
 - a. understanding the context and definition of the stakeholder engagement strategy;
 - b. identification of the list of potential material sustainability matters and impacts, risks and opportunities; and
 - c. determination of the final list of material matters based on an assessment of the materiality of the impacts, risks and opportunities.
6. Following the performance of the materiality assessment process, the undertaking shall disclose:
 - a. the process to identify and assess its material impacts risks and opportunities (ESRS 2 IRO-1),
 - b. the interaction of impacts, risks and opportunities with its strategy and business model (ESRS 2 SBM-3), and
 - c. the Disclosure Requirements in ESRS covered by its sustainability statement (ESRS 2 IRO-2).



Implementation guidance for materiality assessment

7. Stakeholder engagement entails seeking input and feedback to understand the concerns and the evidence of actual and potential impacts of the undertaking on people and the environment and it helps to substantiate the importance of the sustainability matters from the lenses of the affected stakeholder groups.
8. To assess the materiality of impacts of the undertaking, appropriate quantitative and/or qualitative thresholds based on severity for actual negative impacts and severity and likelihood for potential negative impacts are used. 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. To assess their materiality, appropriate quantitative and/or qualitative thresholds based upon anticipated financial effects in terms of performance, financial situation, cash flows, access to finance and cost of capital are used.
10. An assessment performed under GRI constitutes a good basis for the assessment of impacts under ESRS. Reflecting the equivalence of the scope of financial materiality in ISSB standards and ESRS, an undertaking that applies ESRS is expected to be able to comply with the identification of the risks and opportunities to be disclosed under IFRS. The due diligence process, as defined in the international instruments, can help an undertaking both (a) to identify and assess its potential and actual negative impacts, as well as (b) to assess their materiality for reporting purposes based on the criteria of severity and likelihood.



1 Objective

11. The objective of this 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 “materiality assessment” in this document) in accordance with the requirements of Articles 19a or 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”).
12. The content of this document has been developed on the basis of the July 2023 Delegated Act on ESRS.
13. In its implementation support function, EFRAG cannot develop concepts and reporting requirements that go beyond the content of the July 2023 Delegated Act. The purpose of the implementation support material is to illustrate how the provisions of the delegated act may be implemented without introducing new provisions. New provisions can only result from future standard setting activities (e.g., future amendments to draft ESRS) in accordance with the EFRAG due process.
14. As an illustration, when the implementation support documents point to a specific approach or methodology that is not detailed in the Delegated Act, this has to be framed as one of the possible implementation approaches without excluding other possibilities.
15. This guidance includes FAQs on interoperability with ISSB and GRI, illustrating the interactions of the corresponding materiality concepts and processes when applicable.
16. This guidance also includes FAQs related to international instruments or reporting standards that will be useful to perform the materiality assessment and 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 and *OECD Guidelines for multinational enterprises* and *OECD Due diligence guidance for responsible business conduct* which have been used as a basis for the preparation of this document.
17. Finally, this guidance acknowledges that market practice is currently developing for double materiality assessment and that there is no single solution for all undertakings in terms of designing processes and adopting methodologies. Hence, this guidance is aimed at providing tools and mechanisms for undertakings to apply the materiality assessment requirements and disclosures set out in ESRS 1 and 2 while taking full account of their specific facts and circumstances.
18. This paper is organised as follows:
 - a. chapter 2 explains what double materiality is;
 - b. chapter 3 explains the need for the materiality assessment;
 - c. chapter 4 explains how the materiality assessment is performed;
 - d. chapter 5 explains how undertakings could leverage from other sources; and
 - e. chapter 6 complements chapter 2 to 5 with FAQs on:
 - i. impact materiality;
 - ii. financial materiality;



- iii. the materiality assessment process;
 - iv. stakeholder engagement;
 - v. aggregation / disaggregation; and
 - vi. reporting.
19. Acronyms used in this document are:
- a. CSRD – Corporate Sustainability Reporting Directive;
 - b. ESRS – European Sustainability Reporting Standards;
 - c. GHG – greenhouse gases or the GHG protocol;
 - d. GRI – Global Reporting Initiative;
 - e. IROs – impacts, risks and opportunities; and
 - f. ISSB – International Sustainability Standards Board.

2 What is the double materiality assessment?

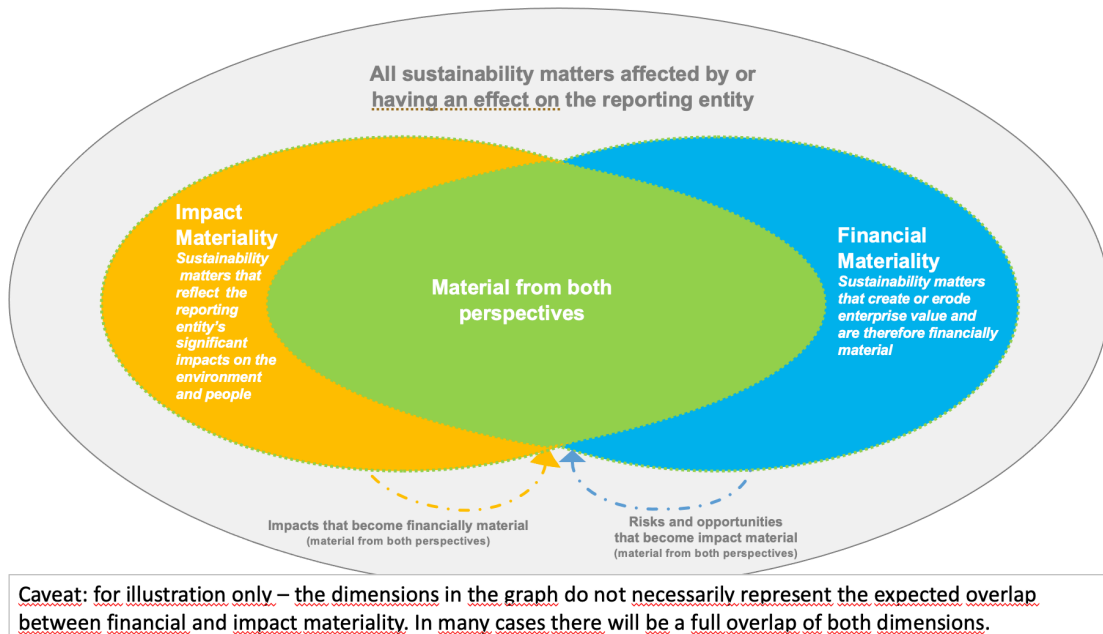
2.1 Recap on the concept of double materiality

20. The CSRD establishes that sustainability reporting shall be based on the principle of double materiality (referred to in this document as “materiality”). This means that a reporting undertaking shall consider both impact materiality and financial materiality when identifying the material matters, which is the basis for the determination of the material information to be disclosed. ESRS include a definition 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 upstream and downstream value chain, including through its products and services, as well as through its business relationships.” (ESRS 1 paragraph 43); and
 - 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 or may generate 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). 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.
21. A sustainability matter can be material from an impact perspective or from a financial perspective or from both (see ESRS 1 chapter 3).
22. Impact materiality and financial materiality are often intertwined. The undertaking has or could have impacts on people or the environment which very often give rise to risks and opportunities resulting from the impacts themselves and/or from modifications to its strategy,



business model(s) and operational processes which are or will be introduced to manage the impacts.

Figure 1: Impact and financial materiality



23. For most material impacts, a material risk or opportunity may crystallise with the passage of time. For example:
 - a. an oil and gas undertaking identifies a material negative impact that arises from not performing the consultation or reaching an agreement with indigenous' people to use their land for the extractions and to relocate the community. Such indigenous community may at a later stage initiate protests that could halt the production of oil and gas at that site and cause material costs for the undertaking due to the days lost to production or the abortion of the project; and
 - b. an undertaking has a number of cases of gender discrimination when promoting employees during the current reporting year; such group of employees can, individually or as a whole, pursue legal proceedings on the grounds of gender discrimination and seek financial compensation within the medium-term and causing reputational damage to the undertaking.
24. Beyond risks and opportunities deriving from impacts, material risks and opportunities also arise in the absence of material impacts connected to the undertaking, in particular when they are due to dependencies on the availability of natural and human resources. For example:
 - a. an undertaking in the mining sector is dependent on water to operate; hence, water shortages may impair its capacity to generate revenue and increase the risk of becoming a stranded asset;
 - b. an undertaking dependent on human resources may experience a high level of staff turnover caused by a local competitor hiring employees at a higher salary, despite the two undertakings having adequate working conditions and practices (i.e., not driven by a material impact) and therefore its operations may be dependent on the availability of human resources; and

- c. an undertaking that has a factory located in a site subject to coastal erosion is exposed to climate physical risk.

2.2 The materiality assessment

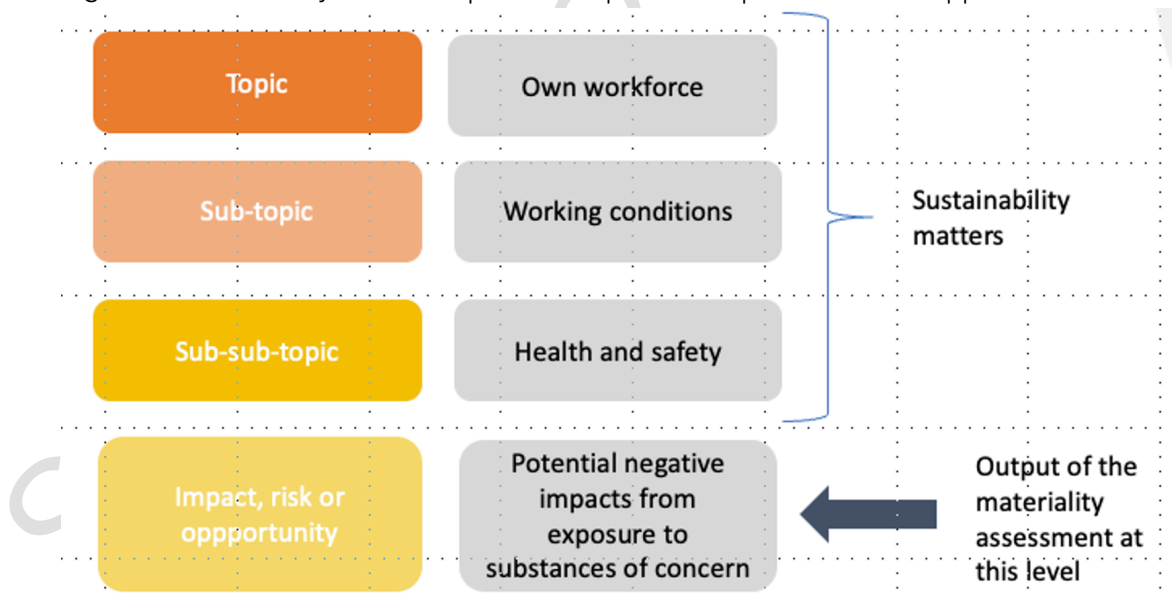
- 25. The undertaking is not required to report on all topics described in the topical ESRS, but only on those that are material. Consequently, the undertaking shall perform a materiality assessment to determine which topics are material and which are not.
- 26. The materiality assessment is therefore the process organised by the undertaking to identify all material impacts, risks and opportunities across environmental, social and governance topics. It is the starting point to determine the material information to be disclosed in the sustainability statement on these material impacts, risks and opportunities.
- 27. The materiality assessment shall be designed to identify all material impacts, risks and opportunities and consequently also to exclude those that are not material. If the process is not appropriately designed, it may expose the undertaking to incomplete reporting (i.e., material impacts, risks or opportunities not being disclosed). For example, an undertaking may not have identified a material impact on child labour from its first-tier supplier as workers from its value chain were not considered in its materiality assessment.
- 28. Once the undertaking has identified the material matters to be reported on, it assesses the materiality of the information, to determine the information to be reported on each material matters (ESRS 1 paragraphs 30, 31, 33 and 34)¹.
- 29. The materiality assessment should be based upon supportable evidence and rely to the maximum extent possible on objective information. It shall reflect the implementation of the impact materiality and financial materiality criteria (ESRS 1 chapters 3.4 and 3.5) and it shall leverage on appropriate thresholds.
- 30. For the sustainability statement to meet the required characteristics of quality (Appendix B of ESRS 1), the process, the way the criteria (ESRS 1 chapters 3.4 and 3.5) are applied, the thresholds and the conclusions of the materiality assessment should be consistent with content and evidences of internal and external reporting, business operations and sustainability management policies and actions, including those that are put in place to fulfil obligations related to sustainability related laws and regulations.
- 31. If the undertaking identifies a large number of impacts, risks and opportunities, it may prioritise them over time in a certain order for management purposes. However, for reporting purposes this prioritisation should not result in material impacts, risks and opportunities being excluded; in particular, when they are not addressed or fully addressed by the undertaking through policies, targets and action plans. This is because the undertaking is expected to report on all its material impacts, irrespective of whether actions have been undertaken or are planned to address them.

¹ The undertaking may also refer to the flowchart in ESRS 1 appendix E for an illustration of this step.

2.3 Understanding key concepts for the materiality assessment: matters; topics; and impacts, risks and opportunities

32. Sustainability matters are defined in the delegated act glossary as environmental, social and human rights, and governance factors, including sustainability factors defined in Article 2, point (24), of Regulation (EU) 2019/2088 (i.e., SFDR).
33. The level of granularity of the matters to be considered ranges from topic level (for example, own workforce) to sub-topic level (for example, working conditions) and, in some cases, to sub-sub-topic level (for example, health and safety). As described in ESRS 1 paragraph 8, the three levels of granularity are collectively called sustainability matters (please see ESRS 1 paragraph AR 16 for a full list of topics, sub-topics and sub-sub-topics). In particular:
 - a. the goal of the materiality assessment is to identify the material impacts, risks and opportunities related to matters that are to be reported (ESRS 2 SBM 3);
 - b. the material impacts and/or material financial effects due to risks and opportunities relate to a matter, and hence that matter becomes material for the undertaking (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).

Figure 2: Sustainability matters, topics, sub-topics and impacts, risks and opportunities



34. The outcome of the materiality assessment is disclosed according to ESRS 2 SBM-3: *Material impacts, risks and opportunities and their interaction with strategy and business model*. The objective of ESRS 2 SBM-3 is to set requirements for the undertaking to disclose its material impacts, risks and opportunities identified at topic, sub-topic or sub-sub-topic level.
35. The undertaking shall disclose its material impacts, risks and opportunities. In preparing its disclosure according to ESRS 2 SBM-3, as per any other disclosure, the undertaking may aggregate information to the extent that it does not obscure material content (ESRS 1 chapter 3.7).



36. Given that the double materiality considers both impact materiality and financial materiality, the undertaking needs to identify whether a topic, sub-topic or sub-sub-topic is material from any of the two perspectives, or both.
37. Once a matter has been identified as material, the undertaking refers to the requirements in the respective topical ESRS to identify the information to be disclosed on the matter (ESRS 1 paragraph 30 and 31). For example, health and safety could be material from a negative/positive impact, and/or risk, and/or opportunity perspective. If an undertaking concludes that health and safety of its own workforce is material (because the undertaking is exposed to a material impact, risk or opportunity in relation to that sub-sub-topic), it shall provide information related to this sustainability matter following the requirements in Disclosure Requirements 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 related to this sustainability matter following the requirements of Disclosure Requirements E2-1 *Policies*, E2-2 *Actions and resources*, E2-3 *Targets*, and E2-4 *Pollution of air, water and soil*.
38. In addition, there could be situations where a sustainability matter is identified as material but is not covered by an ESRS (refer to ESRS 1 paragraph AR 16 for a full list of matters) or is not covered with sufficient granularity. In such situation, as per ESRS 1 paragraph 11, the undertaking shall disclose additional entity-specific disclosures.

3 Materiality assessment – why is it needed?

39. The materiality assessment in sustainability reporting serves to identify all material impacts, risks and opportunities of the undertaking related to a topic, sub-topic or sub-sub-topic (see ESRS 1 paragraph 25-30), and subsequently, the material information (see ESRS 1 paragraphs 31-36) to be disclosed.
40. Such assessment is not limited to the undertaking's own operations as it also includes its upstream and downstream value chain (see ESRS 1 paragraph 63).

3.1 Identification of all material impacts, risks and opportunities of the undertaking

41. The materiality assessment is the process to identify all material impacts, risks and opportunities across environmental, social and governance matters for disclosure purposes (see chapter 4 *Materiality assessment – how is it performed?*). Accordingly, the materiality assessment should be designed to identify all material impacts, risks or opportunities and also to exclude those that are not material. In other words, the undertaking is not to disclose all matters of the sector-agnostic or sector-specific standards but only those material to them including entity-specific matters.
42. Once the undertaking has identified its material impacts, risks and opportunities and the sustainability matters associated with them, it shall assess the materiality of information of the related Disclosure Requirements and their datapoints to determine what to include in its sustainability statement (see chapter 3.2 *Identification of material information*).
43. The ESRS also include a requirement to disclose the materiality assessment process. This is ESRS 2 IRO-1 – *Description of the processes to identify and assess material impacts, risks and opportunities*, whereby the undertaking describes the materiality assessment process put in



place to identify the information to report on. This disclosure provides transparency on the materiality assessment performed, including judgements made by the undertaking throughout the process (for example, on the use of thresholds to assess materiality).

44. The outcome of the materiality assessment process is also to be disclosed according to the provisions set in ESRS SBM-3 *Material impacts, risks and opportunities and their interaction with strategy and business model* and ESRS 2 IRO-2 *Disclosure Requirements in ESRS covered by the undertaking's sustainability statement*. This Disclosure Requirement provides an understanding of the Disclosure Requirements included in the sustainability statement, which indirectly allows to identify the topics that have been excluded as not material. It also provides the conclusion of the materiality assessment for datapoints derived from EU law (Appendix B of ESRS 2) and additional explanations when climate change is assessed to be not material.
45. When the undertaking concludes that a topic is not material, it omits the disclosures required by the corresponding topical ESRS. It may briefly explain the conclusions of its materiality assessment in relation to the omitted topic or topics. However, specific disclosures are to be included in relation to ESRS E1 *Climate Change* when the undertaking concludes that this topic is immaterial and, therefore, it omits all its Disclosure Requirements. According to ESRS 2 IRO-2 Paragraph 57-58, the undertaking shall disclose a detailed explanation of the conclusions of its materiality assessment for ESRS E1 *Climate Change*, including a forward-looking analysis of the conditions that could lead the undertaking to conclude that climate change is material in the future (ESRS 1 paragraph 32).

3.2 Criteria for the identification of material information

46. The concept of materiality of information is complementary to the materiality assessment that leads to the identification of material matters to be reported on (see chapters 2 *What is the double materiality assessment?* and 3.1 *Identification of all material impacts, risks and opportunities of the undertaking*) and it is applied at the more granular level of Disclosure Requirements or datapoints.
47. The criteria to assess the materiality of information are based on relevance as described in ESRS 1 paragraph 31: (a) the significance of the information in relation to the matter it depicts or (b) its decision-usefulness. This is decision-usefulness for the primary users of general-purpose financial information (i.e., financial materiality focussed) and/or for those users whose interest is on the undertaking's impact (i.e., impact materiality). In practice, information that is material under the perspective (b) (decision-usefulness) is in many – if not most - cases also material under the 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 an input for the user of the sustainability statement in its decision-making, as the ultimate beneficiary is not a user of the sustainability statement. When a matter is material from both an impact and a financial perspective, the information needs of the two groups of users (investors and others) is the same in practice. In other cases, this may differ.
48. These criteria support the identification of the information to be reported, in addition to the general requirement to apply the fundamental qualitative characteristics of information (relevance and faithful representation) and the enhancing qualitative characteristics of information (comparability, verifiability and understandability) (see ESRS 1 Appendix B).
49. ESRS 2 IRO 2 requires an explanation of how the undertaking has determined the material information to be disclosed in relation to the impacts, risks and opportunities that it has



assessed to be material, 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*.

3.3 Scope of application of the materiality of information

50. The following paragraphs illustrate how the undertaking shall apply the filter of materiality of information (see ESRS 1 paragraphs 31, 33-35) when disclosing the information on material sustainability matters.
51. The determination of the information to be reported for policies, actions and targets in relation to a material matter is expected to follow the list of Minimum Disclosure Requirements on policies, actions, and targets (see ESRS 2 chapter 4.2 *Minimum Disclosure Requirements on policies and actions* and chapter 5 *Metrics and targets*). In this context, it is important to note that no disclosure is required when the undertaking does not have policies, actions and targets to report on, except for stating this fact (ESRS 1 paragraph 33). The datapoints in the Minimum Disclosure Requirements have been defined to depict the relevant information that a user would require to assess the policies, actions and targets in relation to a material matter. At the same time, reporting that the undertaking does not have policies, actions or targets for a material matter is per se a material information even if the undertaking is not required to include any information in relation to the datapoints prescribed by the Disclosure Requirements relating to the absent policies, actions, and/or targets. In addition, it has an option to include, on a voluntary basis, the timeframe in which it aims to put in place the respective policies, actions and/or targets.
52. The determination of information to be reported for metrics is informed by the assessment of material information, as it is possible to omit Disclosure Requirements and/or datapoints when they are not material (ESRS 1 paragraph 34). This is generally performed starting at the level of the Disclosure Requirement, and then it follows to the related datapoints located either in the Disclosure Requirement² or, when applicable, in Application Requirements. When the information required by a Disclosure Requirement or a datapoint is assessed to be not material (as per criteria of ESRS 1 paragraph 31), and for datapoints not needed to meet the objective of the Disclosure Requirement, the undertaking does not disclose (*may omit*) such information.
53. The criteria to assess the materiality of information (ESRS 1 paragraph 31) are also expected to support the determination of the entity-specific disclosure (ESRS 1 paragraph 30 b) and ESRS 1 paragraph 11 and paragraphs AR 1-5). This is to ensure that entity-specific disclosures (a) meet the qualitative characteristics of information and (b) include all material information related to the four reporting areas.
54. The Disclosure Requirements and datapoints in ESRS 2 are to be reported irrespective of the outcome of the materiality assessment. However, 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 paragraph 31 refer to the '*applicable information*', so also to this case).

3.4 Datapoints derived from EU legislation

55. When the undertaking omits a datapoint derived from 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 material; the undertaking has to include an explicit statement that such

² For ESRS E1 this applies also for datapoints located in Application Requirements.

datapoint is “not material”. ESRS 2 paragraph 56 requires that the undertaking includes in the sustainability statement a table of all the datapoints in ESRS 2 Appendix B, specifying where they can be found in the statement and for those that are omitted as not material, reporting that the respective datapoint is not material.

56. Such datapoints are treated in the same way as any other datapoint for the purposes of assessing the information to be reported on a material matter, i.e., when they relate to policies, targets and actions they follow ESRS 1 paragraph 33 and when they relate to metrics, ESRS 1 paragraph 34 applies and omissions of datapoints are possible.

3.5 Considerations for upstream/downstream value chain

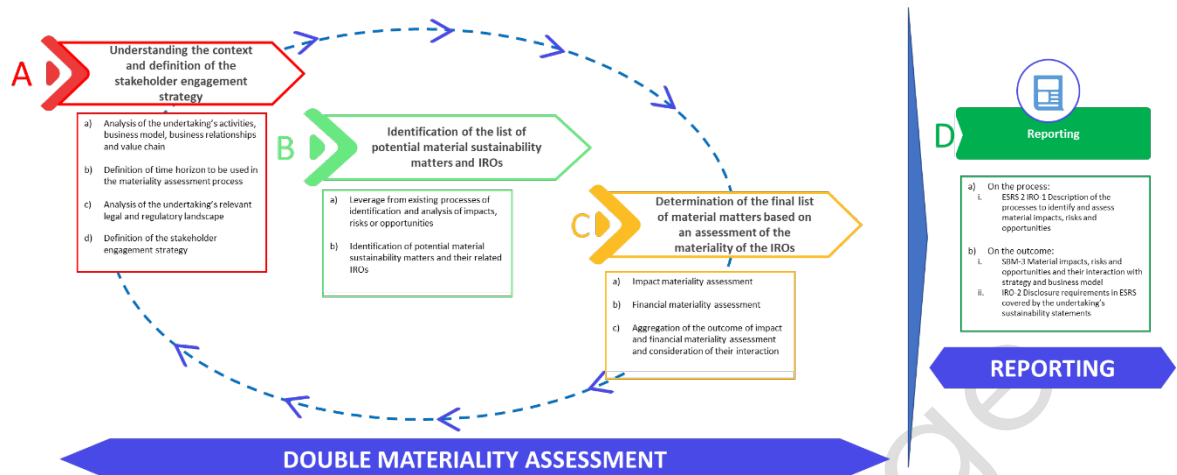
57. The materiality assessment is also used to identify material impacts, risks and opportunities connected with the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain (for further detail see Value Chain Implementation Guidance).

4 Materiality assessment – how is it performed?

58. ESRS do not mandate how the materiality assessment shall be conducted by an undertaking, or how the process should be designed. No one process would suit all types of economic activities, location(s), business relationships or value chains (upstream and/or downstream) of all the undertakings applying ESRS.
59. An undertaking, based on its specific facts and circumstances, shall design a process that is fit for purpose considering the requirements of ESRS 1 Chapter 3, and what needs to be disclosed regarding the materiality assessment and its outcome (see ESRS 2 IRO-1, IRO-2 and SBM-3). Therefore, the ESRS provide several aspects that an undertaking takes account of when designing its materiality assessment process.
60. The undertaking's materiality assessment shall reflect the impact and financial materiality perspectives, as well as possible interlinkages between the two. This means that the undertaking does not need to perform two separate and independent materiality assessments. The identification of material impacts is generally a starting point since the financial materiality assessment shall consider the outcome of the impact materiality assessment (see ESRS 1 chapter 3.3 Double materiality) as material impacts may trigger material risks and opportunities. Nevertheless, the undertaking shall also consider the possible matters that are financially material without being material from the impact perspective.
61. A materiality assessment that would meet the requirements of ESRS 1 (see chapter 3 and paragraphs AR 6 to AR 16) could include the following steps which are derived from current best practices, alternative approaches being equally possible:



Figure 3: Example of materiality assessment process



62. Chapter 6.3 FAQ on the materiality assessment process has further guidance on the process.

4.1 Step A: Understanding the context and definition of the stakeholder engagement strategy

63. This step may consist of the following:

- a. the analysis of the undertaking's activities, business model, business relationships and value chain (upstream and/or downstream) (linked to ESRS SBM-1) which includes, but is not limited to:
 - i. the analysis of the undertaking's business plan, strategy, financial statements and when applicable information provided to investors;
 - ii. the mapping of the undertaking's activities, products/services, the geographic locations of these activities;
 - iii. the mapping of the undertaking's business relationships and upstream and/or downstream value chain, including type and nature of business relationships; and
 - iv. the identification of the perimeter of the information to be reported (its own operations and upstream/downstream value chain) for the materiality assessment.
- b. the definition of time horizon (short-, medium- and long-term) to be used in the materiality assessment process (see ESRS 1 Chapter 6.4);
- c. the analysis of the undertaking's relevant legal and regulatory landscape. This analysis should factor in the relevant EU regulation and other sector specific regulations. The undertaking may also extend the analysis to:
 - i. media reports;
 - ii. peers' analysis, existing sector-specific benchmarks; and
 - iii. other publications on general sustainability trends and scientific articles; and
- d. the definition of the stakeholder engagement strategy (see chapter 4.2 Role and approach to stakeholder engagement in the materiality assessment) which includes the identification of the key stakeholders. This strategy is determined by the following aspects:

- i. the analysis of the existing stakeholder engagement initiatives (for example, those with the communications or investor relations teams of the undertaking);
 - ii. the definition of a list of key groups of stakeholders that are or could be affected by the undertaking's own operations or upstream/downstream value chain whilst considering the nature of the relationship. It may be the case that different groups of stakeholders can be identified per activity, product or service and are to be prioritised for a particular sustainability matter; and
 - iii. the definition of the stage of the materiality assessment process in which the engagement will take place. For example, the engagement could be to validate the list of potentially material matters. Similarly, for impact materiality, the engagement could be focussed on the scale aspect of severity and on time horizons (i.e., short-, medium- or long-term).
64. Chapter 6.4 FAQ on stakeholder engagement has further guidance on the role of stakeholders.

4.2 Step B: Identification of the list of potential material sustainability matters and impact, risk and opportunities

65. This step may consist of the following:
- a. building on existing processes of identification and analysis of impacts, risks or opportunities such as those listed below:
 - i. the outcome of existing materiality assessment processes based on other frameworks. In this context, ESRS 1 paragraph AR 16 provides the universe of ESRS sustainability matters, therefore a mapping exercise could be conducted for completeness.
 - ii. the outcome of the existing due diligence process;
 - iii. the feedback or inputs received from stakeholder engagement processes already in place, i.e., customer / employee satisfaction surveys, grievance mechanisms, etc.; and
 - iv. benchmark analysis of material topics for peers/ the sector specific matters.
 - b. identification of potential material sustainability matters and their related impacts, risks and opportunities. To do so, the undertaking may follow one of the following approaches:
 - i. **"Top-down" approach:** This is the identification of the list of potential material sustainability matters at topic / sub- topic / sub-sub topic level followed by the assessment of the existence of the related potential material impacts (actual / potential, negative or positive), risks or opportunities. Depending on the level of maturity of such assessments by the undertaking, the identification of the potential matters could have two different starting points:
 - the list in ESRS 1 paragraph AR 16 as it summarises the sustainability matters covered by ESRS (see FAQ 9 *Is it sufficient to evaluate the list of sustainability matters of ESRS 1?*). This list of topics/sub-topics could be



- enhanced to include the results of step A above; for example, information gathered from engagement initiatives with relevant stakeholders and experts, scientific and analytical research performed; or
 - the list of potential material topics/sub-topics/ sub-sub-topics that the undertaking has developed using external and internal such as its own Enterprise Risk Management system, when it covers sustainability matters for risks and opportunities, or the output of the due diligence process for impact materiality. This list is to be compared with the list of ESRS 1 paragraph AR 16 for completeness, to ensure that all potential material topics/subtopics have been considered.
 - ii. **“Bottom-up” approach:** This is the identification of the list of potential material matters on the basis of the impacts, risks and opportunities which are identified at a granular level. The undertaking may then group these impacts, risks and opportunities into topics or sub-topics, which become the list of potential material matters to be compared with the classification defined in ESRS 1 paragraph AR 16.
66. The outcome of this step is the definition of a list of potential material matters (topics and sub-topics) and their related impacts, risks and opportunities. In some cases, the undertaking may, for those sub-topics (or sub-sub topics) that are not material on an individual basis, aggregate them at a higher level (topic level or sub-topic level), if that higher level is material due to another sub-topic (or sub-sub topic) being material at the level below. An example is working conditions where for an undertaking *social dialogue, collective bargaining and freedom of association* are not material on an individual basis but altogether make these three factors combined material for the undertaking.
67. Chapter 6.5 FAQ on aggregation/disaggregation has further guidance on aggregation/disaggregation.

4.3 Step C: Determination of the final list of material matters based on an assessment of the materiality of the impacts, risks and opportunities

68. This is the last step of the materiality assessment process whose outcome is the list of material impacts, risks and opportunities. This may include the following:

4.3.1 Impact materiality assessment

69. The undertaking shall apply objective criteria set out under chapter 3.4 of ESRS 1 using appropriate quantitative and/or qualitative thresholds to assess the materiality of current and potential impacts, which is based on severity and, for potential impacts, also likelihood (see chapter 4.6 *Setting thresholds for impact materiality*).
70. Therefore, the undertaking shall go through the list of potentially material impacts defined in step B above and apply the criteria determined by severity, which is scale, scope and irremediable character of the impact for actual negative impacts. For potential negative impacts, the undertaking estimates the likelihood of the impact occurring and maps it to the relevant time horizon. For actual positive impacts, the criteria are scale and scope and for potential positive impacts, the undertaking shall estimate the likelihood of occurrence.



71. Stakeholder engagement informs this step of the materiality assessment as key stakeholders could assess, validate and ensure completeness of the final list of material impacts; in particular, for the scale and irremediable character determination and the estimation of likelihood within impact materiality.
72. Chapter 6.1 *FAQ on impact materiality* provides further guidance on impact materiality. See also chapter 5.3 *Leverage from international instruments of due diligence*.

4.3.2 Financial materiality assessment

73. Material risks and opportunities for the undertaking generally derive either from impacts or from dependencies. To assess their materiality, appropriate quantitative and/or qualitative thresholds based upon anticipated financial effects in terms of performance, financial situation, cash flows, access to and cost of capital are used.
74. 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 shall go through the list of potentially material risks and opportunities from step B above and apply an objective set of thresholds for likelihood and magnitude. When applicable, the undertaking may compare those to the ones used in its ERM processes (when the latter covers also sustainability risks) and estimate the likelihood of occurrence of the risks and opportunities or their related financial effects accordingly.
75. In addition, the undertaking shall consider the list of potential material impacts to assess whether they are sources of current or potential risks and opportunities.
76. Engagement with the undertaking's business unit functions may be appropriate to assess, validate and ensure completeness of the list of material risk and opportunities together with investors of the undertaking and other financial counterparties (e.g., banks).
77. Chapters 6.2 *FAQ on financial materiality* has further guidance on financial materiality.

4.3.3 Aggregation of the outcome of the impact and financial materiality dimensions and consideration of their interaction

78. The objective of this final step is to consolidate the results of the previous steps and obtain the list of material impacts, risks and opportunities which will be the basis for the preparation of the sustainability statement. The analysis performed at material topic/sub-topic or sub-sub-topic level is to be converted into material impacts, risks and opportunities if this has not taken place previously. This would comprise:
 - a. application of the defined thresholds to the results of the impact materiality assessment;
 - b. application of the defined thresholds to the results of financial materiality assessment;
 - c. aggregation of the results of impact and financial materiality assessment with an identification of those material impacts that will lead to material risks and opportunities;
 - d. where appropriate, the undertaking, may further aggregate or group the identified material impacts, risks and opportunities into sub-topics or even topics (following the criteria set in Step B), to ensure the most appropriate level of granularity; and



- e. validation of the aggregated double materiality results with management (to assess and validate the completeness of the list of material impacts, risks and opportunities).

4.4 Step D: Reporting

- 79. Following the performance of the materiality assessment process, the undertaking shall report the assessment process and its output 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 statements*.
- 80. Chapter 6.6 *FAQ on reporting* has further guidance on reporting.

4.5 Role and approach to stakeholders in the materiality assessment process

- 81. The concept of stakeholder engagement has been highlighted by international instruments of due diligence, namely the OECD MNE and UNGP. The due diligence process enables the undertaking to determine its impact on people or the environment. ESRS 1 paragraph 24 describes that engagement with affected stakeholders is central to the undertaking's due diligence and impact assessment, insofar that their perspectives inform the materiality process.
- 82. Stakeholder engagement entails seeking input and feedback to understand the concerns and the evidence of actual or potential impacts on people and environment connected with the undertaking from those stakeholders that could be affected.
- 83. Consulting with stakeholders and incorporating their views into the materiality assessment process helps the undertaking to substantiate the perspectives of the affected stakeholder groups in determining how relevant the sustainability matters are for them. For example, engaging with the undertaking's employees on health and safety matters. This includes feedback received from stakeholders within its ongoing engagement with them as part of the undertaking's business practices.
- 84. On impact materiality, the focus of the stakeholder's engagement could be on the scale (i.e. how grave the negative impact is or how beneficial the positive impact is for people or the environment – see ESRS 1 AR 10) and the time horizons when impacts are expected to materialise. The undertaking shall consider engaging them in step C of the materiality assessment process, when the potential list of sustainability matters / IROs is being assessed, rather than at an initial stage of the process.
- 85. Stakeholder engagement may equally corroborate the evidence that support financial materiality of sustainability matters. The conclusions of the ESRS financial materiality assessment should be based on supportable evidence, which include views and interests of stakeholders. 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 is expected to leverage existing mechanisms of dialogue with shareholders, other investors, and lenders, to support its financial materiality assessment process.

86. In its approach to stakeholders' dialogue, the undertaking shall consider that stakeholders other than investors may also be interested in general-purpose sustainability-related financial information. For example:
- a. suppliers are keen to understand whether an undertaking will be financially stable enough to remain its customer in the future;
 - b. affected communities are interested in whether the provisions set aside to rehabilitate a polluted production site are sufficient to cover the necessary rehabilitation activities; and
 - c. current and prospective employees may want to learn how long an undertaking is likely to be financially stable given the financial risks it is exposed to.
87. In situations when consultation with stakeholders is not possible, the undertaking may consider appropriate alternatives such as consulting credible independent experts such as, for example ESRS S3 *Affected communities*, where an NGO representing this community could provide feedback.
88. ESRS 2 requires an explanation of whether and how the process to identify, assess and prioritise the undertaking's potential and actual impacts includes consultation with affected stakeholders (Disclosure Requirement IRO-1, paragraph 53 (b) iii). This means that, even though ESRS do not mandate behaviour, the undertaking will be required to disclose engagement with stakeholders when identifying and assessing actual and potential negative impacts. The impacts, risks and opportunities identified and assessed at this stage will then inform the determination of those that are material for reporting purposes.
89. Chapter 6.4 *FAQ on stakeholder engagement* provides further guidance.

4.6 Setting thresholds for impact materiality

90. To assess the materiality of impacts, ESRS 1 paragraph 42 states that an undertaking shall apply criteria set under ESRS 1 chapter 3.4 using appropriate quantitative and/or qualitative thresholds.
91. Impact materiality is determined by severity for actual negative impacts and severity and likelihood for potential negative impacts. Severity is based on factors that are scale, scope and irremediable character for negative impacts; and scale and scope for positive impacts. Therefore, these factors should be the basis for determining the thresholds. Also, when defining the threshold, the undertaking may consider the overall number of potential impacts across environmental, social and governance.
92. However, ESRS 1 does not prescribe how to set such thresholds.
93. It also states that the undertaking's due diligence process informs the impact materiality assessment. In this context, the undertaking may use its ongoing due diligence process or other risk management processes to inform its thresholds setting and determine whether impacts are material for reporting purposes. In those processes, the undertaking's management of adverse impacts is driven by an analysis of severity and/or risk prioritisation, which may inform the assessment of impact materiality.
94. Such concept of establishing a threshold commensurate with the overall number of potentially material matters may mirror the principle of prioritisation for action of the most severe impacts



under the international due diligence instruments. However, in the case of ESRS such threshold is not set to define how to sequence or prioritise the actions but rather to define a “cut off” for information to be disclosed as material.

95. When setting up the threshold, attention should be paid 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 available to support the materiality assessment.
96. For negative impacts, the starting point for determining a threshold should be the scale (how grave) and scope (how widespread). This means that the gravity of an impact and the number of individuals or perimeter that are or will be affected will both be relevant considerations.
97. Irremediability is the third relevant factor of severity, used here to mean any limits on the ability to restore those affected to a situation at least the same as, or equivalent to, their situation before the negative impact.
98. It is to be noted that if one of these factors (scale, scope and irremediable character) is significant, the impact would become “severe”. Typically, there is an interrelation between these factors; hence, the greater the scale or scope of an impact, the less it is remediable.

4.6.1 Current impacts

99. In terms of applying the concepts described above and as an illustration, an undertaking could map its actual impacts in a two-dimensional graph where scale and severity are the axis, categorised in a range from low to high impact and combined with irremediability as symbolized by the arrow (figure 4a); or all three are arranged in column form (figure 4b).



Figure 4a: Graphical representation of impact severity for current impacts (scale, scope combined with irremediability)

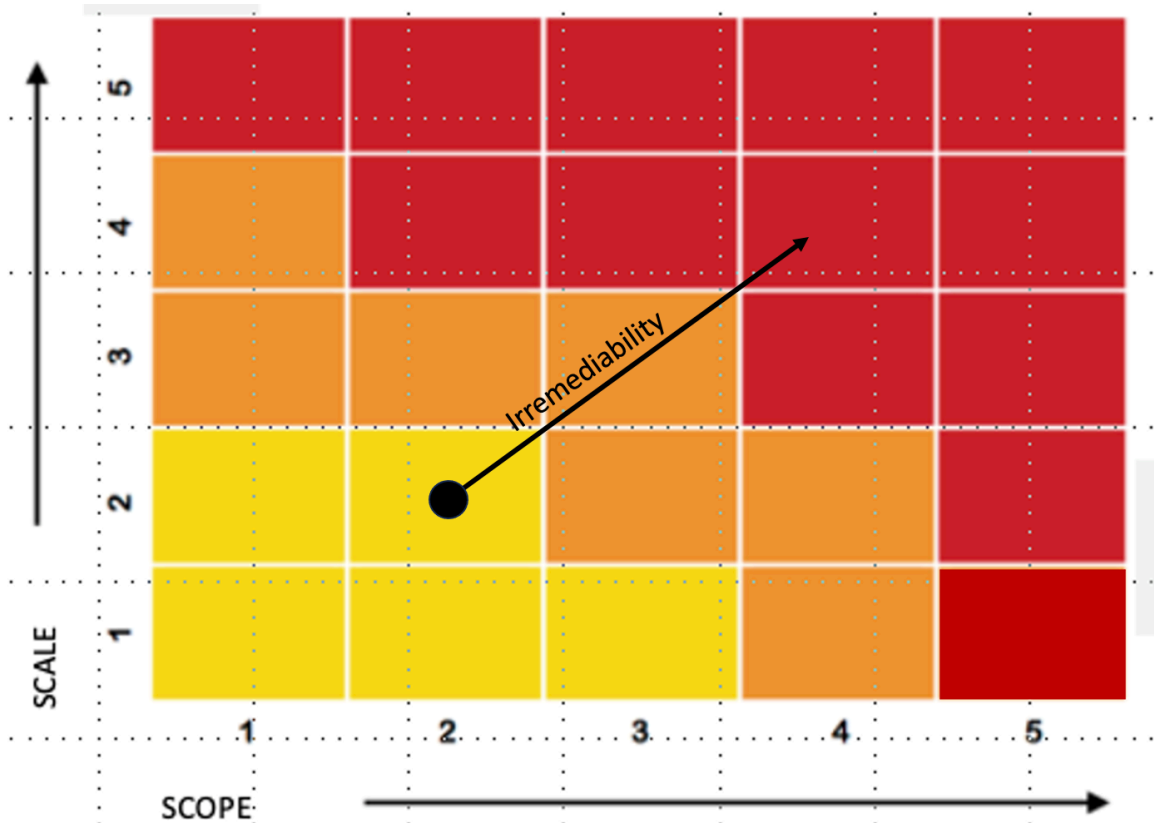


Figure 4b: Graphical representation of impact severity for current impacts (scale, scope, and irremediability arranged in column form)

potential material impact	Severity assessment			Conclusion on materiality
	Scale	Scope	Irremediability	
impact 1	Low	Medium	Low	no yes yes
impact 2	Medium	High	Low	
impact 3	High	Medium	Medium	
...				yes
impact N	High	Low	Medium	

color coding



100. In terms of scale, this represents how grave is the impact for negative impacts and how beneficial the impact is or could be for positive impacts. Aspects that affect the scale can be whether the impact leads to non-compliance with laws or regulations; for example, if a negative impact leads to a violation of human rights. In this context, a reasonable objective measure of impacts to be used in the categorisation of the various impacts may not be available (i.e. a quantitative measure). Hence the relevance of using the principle of relative

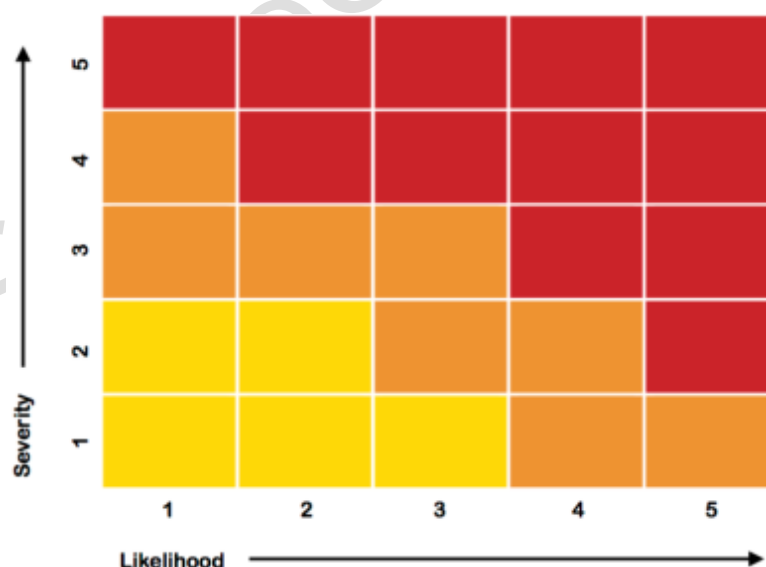
severity amongst the various impacts to categorise them. The scale is also linked to the irremediable character. In the case of positive impacts, the irredeemable character is not a factor to consider.

101. In terms of scope, the measurement may vary depending on the sustainability matter in question. In some cases, the number of individuals affected could be the appropriate basis (for example, percent of employees) or in other cases the number of countries affected by such matter may be relevant (for example, 40 percent of the suppliers are in countries where such negative impact arises). The scope factor could be assessed on a more quantitative basis than the other factors and hence translating this value into a soft quantitative scale such as the 1 to 5 mentioned above could be more direct.

4.6.2 Potential impacts

102. For potential impacts, the likelihood dimension 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.
103. Following on 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 altogether into the severity axis and likelihood of occurrence would be represented in the horizontal axis.
104. 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 using general terms (e.g., unlikely, highly likely) or mathematically using probability (e.g., 10 in 100, 10 percent) or a frequency over a given time-period (e.g., once every 10 years).
105. A similar approach to the current impacts could be applied whereby the threshold for reporting material impacts is defined as the red area in the graph.

Figure 5: Thresholds for materiality of potential impacts



4.6.3 Examples

106. The assessment of the three factors of severity for a negative impact on violations of human rights could be as follows:
- a. scale: extent of infringement of access to basic life necessities or freedoms (e.g., education, livelihood etc);
 - b. scope: number of people impacted, percentage of identifiable groups of people impacted; 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).
107. Another example could be undertaking A that is a large undertaking with a material pollution matter regarding a river next to its factory. In the following year, undertaking A is acquired by group B. The scale of the pollution of the river impact of undertaking 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 high on 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 categorisation of scale or irremediable character.

5. Materiality assessment – how to leverage other sources³?

5.1 Leveraging the GRI standards

108. An assessment performed under GRI is focussed on the impact materiality dimension but not on the financial materiality dimension (see chapter 2.1). The GRI framework is not based on double materiality like ESRS. However, the impact dimension is the same for GRI and ESRS even if the scope of environmental, social and governance matters under GRI may not exactly be the same with that of ESRS. Therefore, an assessment performed under GRI constitutes a good basis for the assessment of impacts under ESRS and the financial materiality dimension is to be added when moving from the GRI reporting framework to that of ESRS.
109. Several synergies can be observed for those undertakings that are currently reporting under the GRI Universal Standards 2021 framework in terms of:
- a. impact materiality assessment process: 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. universe of potential impacts identified using the GRI standards: they are compatible in principle with the list of matters in ESRS 1 paragraph AR 16 (and as a result with the ESRS architecture of topics). In addition, GRI materiality assessment can inform the process of identifying the entity-specific impacts; and

³ The content of this chapter reflects the thinking of the EFRAG Secretariat and has not been validated by GRI nor by ISSB.

- c. role of due diligence and stakeholder engagement: it is central in both GRI and ESRS frameworks in informing the impact materiality assessment.

5.2 Leveraging the ISSB standards

- 110. In the intentions and expectations of EFRAG, as illustrated in the paragraphs below, the criteria for financial materiality and materiality of information in ESRS and the corresponding materiality approach in IFRS S1 are, in principle, aligned.
- 111. The financial materiality assessment in ESRS 1 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 (ESRS 1 paragraph 48, aligned with IFRS S1 paragraph 1). The definition of financial materiality is aligned in the two standards⁴.
- 112. Reflecting the equivalence of the scope of financial materiality in the two frameworks, an undertaking that applies ESRS is expected to be able to comply with the identification of the risks and opportunities to be disclosed under IFRS, using the outcome of its ESRS assessment of financial materiality. In other terms, the same financial materiality assessment process can support the identification of the risks and opportunities for both IFRS and ESRS purposes.
- 113. The general criterion for assessing the materiality of information and therefore to support the identification of the information to be reported on a material matter (ESRS 1 paragraph 31) is expected, in most cases, to rely on decision-usefulness (see chapter 3.2); which is also the criterion used in IFRS S1 to identify the information to be reported (as material). While in ESRS the assessment of what is decision-useful considers both investors and other stakeholders, in IFRS this is limited to the users' needs of investors. However, for the financial materiality component of ESRS, the two perspectives are expected to be equivalent.

5.3 Leveraging international instruments of due diligence

- 114. The materiality assessment of an undertaking's impacts, risks and opportunities is informed by the outcome of its due diligence process, as defined in the international instruments of the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises.
- 115. 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 value chain and identifying the impacts originated there. Additionally, the due diligence instruments provide criteria to prioritise actions, based on the severity and likelihood of the impacts previously identified.

⁴ 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).



116. In that sense, the due diligence process can help an undertaking both (a) to identify and assess its potential and actual negative impacts (see step B in chapter 4.2), as well as (b) to assess their materiality for reporting purposes based on the criteria of severity and likelihood (see step C in chapter 4.3.1). The identification of material impacts also supports the identification of material sustainability risks and opportunities, which are often a consequence of such impacts.
117. Through this process the undertaking can also identify affected stakeholders, which should be engaged when assessing the materiality of the impacts, risks and opportunities.

6 Frequently Asked Questions (FAQ)

6.1 FAQ on impact materiality

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

118. It is based on its impact to people or the environment, which are in turn stakeholders for the undertaking.
119. Impact materiality means the impacts on people and/or the environment connected with the undertaking's own operations and value chain, including through its products and services, as well as through its business relationships. Hence, the severity of such impacts on the people and/or environment for actual or potential impacts. To assess such impacts stakeholder engagement is critical as described in FAQ 16 *Do ESRS mandate to actively engage with stakeholders?*
120. In contrast, financial materiality is focussed on the materiality to the undertaking, because it is reflecting the effects of sustainability matters on the undertaking's cash flows, financial performance, financial position, access to finance in the short-, medium- or long term or cost of capital.
121. In many cases material impacts are also associated with material risks and opportunities and, as a result, they are also 'material for the undertaking'. However, impact materiality is assessed based on severity for 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" with an impact?

122. Impact materiality includes impacts connected with 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 with impacts in various ways as described below.
123. The undertaking may be single-handedly responsible for the impacts, as the **impacts are directly caused** by its operations, products or services to people or the environment. For example:
 - a. exposure of the undertaking's own workers to hazardous working conditions without adequate safety equipment in own operations;



- b. being the sole source of pollution in a community's drinking water supply due to chemical effluents from production processes;
 - c. long-term pattern of failing to hire, support and promote qualified women;
 - d. failing to protect the confidentiality of personal data held about employees or contract workers, customers or other individuals; and
 - e. for a positive impact, an undertaking in the energy production sector adopting measures that lower the cost of renewable energy for customers, thereby allowing more customers to switch to renewable energy, and thus contributing to mitigating climate change.
124. **Impacts to which the undertaking has contributed** to are those not caused directly and solely by the undertaking's operations, products or services.
125. When the impact is not caused solely by the undertaking but in conjunction with a third party: the undertaking's action or omission would not, single-handedly, cause the impact, but together with others' actions or omissions, it leads to the impact. For example:
- a. several factories/sites in an area release harmful emissions into the air. Each release is below the harmful limit, but together they lead to the air being so polluted that a local community's air quality is affected; and
 - b. a clothing undertaking has its own production line in a supplier factory with standard eight-hour shifts; after working on this production line, the workers work on a parallel production line of a competitor for another eight hours.
126. When the undertaking facilitates or incentivises another party to cause or contribute to the impact. For example:
- a. changing buying requirements for suppliers repeatedly without adjusting production deadlines and prices, thus pushing suppliers to breach labour standards in order to deliver; and
 - b. sending a negotiation team to drive down price with the supplier, without considering impact this may have on working conditions.
127. **Impacts directly linked to the undertaking's** operations, products, and services through its business relationships may arise in situations where such impacts are not caused nor contributed by the undertaking, but the entities that caused or contributed to the impact are linked to the undertaking. Consequently, the undertaking is linked to the impact. For example: Embroidery on a retail undertaking's clothing products being subcontracted by the supplier to child labourers in homes, counter to contractual obligations.
128. Distinguishing the type of involvement is important given that it could lead to a different categorisation of the negative impact and it is linked to international instruments on due diligence and human rights will require different responses to it and this may need to be reflected in the different types of policies, actions and targets that the undertaking has in place and that are to be reported



FAQ 3: What are material impacts, risks or opportunities in the value chain?

129. See Value chain implementation guidance: FAQ 3: How should the materiality assessment process be organised to properly capture material impacts, risks and opportunities that arise in the value chain?

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

130. No. Impacts are to be assessed on a gross basis. Positive impacts on the environment and people cannot be netted against negative impacts.
131. The following non exhaustive list of principles should be applied:
- a. different nature of impacts (negative vs. positive): an undertaking shall not net negative impacts with positive impacts of a different nature (in the reporting year or in future years) – this would contradict ESRS 1 paragraph 56: “... *The undertaking shall not aggregate material items that differ in nature.*” and the qualitative characteristics of quality (Appendix B of ESRS 1);
 - b. timing of impacts (current vs. future): an undertaking shall not net negative/positive impacts in the reporting year with positive/negative impacts of the same nature in future years; and.
 - c. location (in own operations vs. in the value chain): an undertaking shall not net negative/positive impacts in own operations with positive/negative impacts of the same nature in the value chain (in the reporting year or in future years).
132. Netting should not be confused with compensation/offsetting. ESRS E1 – *Climate change* and ESRS E4 – *Biodiversity and ecosystems* have specific requirements in that respect.

6.2 FAQ on financial materiality

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

133. No, it is not the same. However, the objective remains the same.
134. The assessment as to whether the information is considered to be material for decision-making of those who provide, or may provide in the future, resources to the undertaking remains the same. However, financial materiality for the sustainability statement goes beyond the scope of the materiality used for financial statements. As a result, when defining the thresholds for financial materiality used in the preparation of sustainability statement, inspiration could be drawn from criteria and thresholds used in the preparation of the financial statements.
135. The differences between financial materiality for financial statements and financial materiality for sustainability statement relate to the following aspects:
- a. sustainability reporting includes disclosures of potential financial effects of material risks or opportunities that are not captured or not yet fully captured by financial reporting at the reporting date and that could be reasonably expected to result in



- financial effects for the undertaking. Therefore, risks and opportunities are not limited to the definition of assets and liabilities for the financial reporting;
- b. the information on the parent and its subsidiaries are expanded in the sustainability statement to include information about material risks and opportunities arising from the undertaking's (parent and subsidiaries) relationships in the value chain; and
 - c. future events may trigger anticipated sustainability-related risks and opportunities while financial risks are based upon past events;
 - d. time horizons are longer in sustainability reporting as mid-term and long-term are considered for risks and opportunities and they are not constrained by the financial planning horizon or by the historical cost convention.

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

136. No. As described in FAQ 5 *Is materiality for financial statements the same as financial materiality for the sustainability statement?*, the basis for preparation and time horizons of financial and sustainability reporting differ. The concept of current and anticipated financial effects defined in the glossary 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).
137. Reporting certain financial effects associated with material sustainability matters in sustainability reporting goes beyond what is required to be recognised and measured in the primary financial statements and disclosed in the notes for those matters. 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. In this case potential adjustments to the carrying amount that are of interest for users of sustainability statement may not meet the accounting criteria for recognition in financial statements at the reporting date;
 - b. future assets, liabilities, income and expenses that are of interest to users of sustainability statement may have to be recognised in financial reporting at a later stage, when the accounting recognition criteria will be met; and
 - c. factors of value creation that do not meet the financial accounting definition of assets and liabilities and/or the related recognition criteria but contribute to the generation of cash flows and more generally to the development of the undertaking.

FAQ 7: How should the undertaking set thresholds for financial materiality?

138. ESRS do not describe how to define financial materiality thresholds. However, ESRS 1 paragraph AR 15 states in that respect: "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.”

139. 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, net equity. Similar approaches are in practice used to assess materiality of an item for the preparation of financial statements and may be a possible 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 the preparation of financial statements. As an illustration, this may result in the need to consider the cumulative effect of a sustainability matter on revenues, costs, etc. over a long period. Similarly, a threshold for likelihood needs to consider the cumulative probability over a long period of time, to cover the long-term horizon.
140. In this context, the materiality assessment cannot be limited to the scope of financial effects that affect (or will affect in the future) items recognised in the financial statements. The undertaking shall as well consider financial effects associated with dependencies on natural and social resources that do not meet (or do not meet yet) the criteria for accounting recognition (ESRS 1 paragraph AR 14 and AR 15).
141. 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). Also in this case, there is a similarity with financial reporting, where materiality is not confined to quantitative aspects, but an information may be material due to its nature, i.e., reflecting a qualitative approach to materiality.
142. When the undertaking has in place mechanisms of dialogue with its shareholders, investors and lenders, it may corroborate the determination of its materiality threshold with input from their users’ needs. This is because the ultimate goal of financial materiality is to report on information that, if omitted, misstated or obscured, could reasonably be expected to influence decisions that those stakeholders make on the basis of the undertaking’s sustainability statement (ESRS 1 paragraph 48).
143. As in many cases sustainability matters that generate material impacts are also sources of material risks and opportunities, in its financial materiality assessment. The undertaking may assume that sustainability matters are financially material when they have been assessed to be material from an impact perspective, unless there is evidence that this is not true at the level of a specific matter.

6.3 FAQ on the materiality assessment process

FAQ 8: How frequently should an undertaking update its sustainability materiality assessment?

144. The CSRD defines the frequency of sustainability reporting under ESRS which is annual as the sustainability statement forms 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.



145. However, if the undertaking has performed a thorough materiality assessment in the previous periods and can conclude based on appropriate evidence that the outcome of that assessment is confirmed also at the reporting date, the preparation of the sustainability statement may leverage the conclusions previously reached. This may be the case when, for example, the undertaking assesses that there have been no material changes in the organisational and operational structure of the undertaking and there have been no material changes in the external factors that could generate new, or modify existing impacts, risks and opportunities or that could impact the relevance of a specific disclosure. Examples of changed material facts and circumstances could be:
- a. a major M&A 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;
 - c. a global event such as a pandemic or entering into a new material business relationship that is likely to have a severe impact on human rights; and
 - d. a shift in users' needs, such as when the level of public scrutiny on a given matter significantly increases compared to previous periods.
146. The analysis performed for the preparation of the sustainability statement at each reporting period should be sufficiently robust and proportionate to capture the possible changes, including in the value chain. If so, the undertaking may limit the analysis to an annual update of its previous materiality assessment.
147. Practices may vary, as some undertakings may prefer fully updating their materiality analysis (i.e., process, criteria, research on sustainability matters, multi-stakeholder engagement...) on a 2 or 3 years cycle, whilst others may prefer performing targeted updates on an annual basis (i.e., list of impacts or risks and opportunities, while not repeating the initial materiality steps).
148. The materiality assessment is a dynamic process that will be subject to the inherent evolution of the undertaking and needs to be updated on an ongoing basis.

FAQ 9: Is it sufficient to evaluate the list of sustainability matters of ESRS 1 paragraph AR 16 to identify material matters?

149. No.
150. 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."
151. The list in ESRS paragraph AR 16 is a good starting point for the identification of sustainability matters, but it should not be applied as a checklist approach substituting a materiality assessment. It is an inventory of the sustainability matters covered in sector agnostic topical ESRS. Sector-specific⁵ and entity-specific sustainability matters (see ESRS 1 paragraph 11) should also be considered on top of this list.

⁵ Future sector specific ESRS will identify where appropriate additional sustainability matters.

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

FAQ 10: How to consider time horizon in the double materiality analysis?

153. A sustainability matter might be material from an impact or financial perspective in the short-, medium- or long-term. As such, time horizon is an essential component of the materiality assessment and shall be factored into the process. In the steps of the double materiality analysis the short-, medium- and long-term time horizon may be considered:
- for a proper **understanding** of the undertaking's facts and circumstances: in this step it is necessary to set an appropriate time horizon based on the context of the undertaking;
 - for a proper **identification** of the list of sustainability matters: the undertaking needs to reflect over the entire time horizon (short/medium/long) to determine whether the impact, risk or opportunity may occur or not;
 - for the **assessment** of material matters based on materiality of impacts, risks and opportunities: the undertaking may consider that the financial effects linked to material impacts may materialise on a different time horizon from the one of the impact. In addition, when determining which of the impacts, risks and opportunities are material, thresholds and dependencies might be affected by the time horizon.

Examples:

154. The undertaking might for instance conclude that:
- the financial effect of assets currently used that could become stranded assets in the long-term due to environmental risks to be not material as they will be fully amortised at that future point in time;
 - the financial effect of a risk probable to occur in the long-term to be not material due to discounting; or
 - an environmental impact to be material in the short-term but not in the long-term as it reasonably expects technology to be available in the long-term due to innovation to avoid the impact once it is developed.

FAQ 11: Should the assessment of impacts, risks or opportunities rely on quantitative information?

155. If possible, yes, as quantitative measures of impacts are the most objective evidence of how severe an impact is.
156. However, 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"), adding quantitative information to the analysis would not bring much value to the materiality assessment.
157. Quantitative information would however be of interest where a topic is on the edge of the material/non-material border based on qualitative information and/or where there are many diverse views. In that case, quantification could be relevant to corroborate the conclusion. This



could include impact valuation, which would also have the advantage to make different impacts comparable.

158. In this context, the undertaking may consider adopting measures of impacts inspired by the indicators that are included in the Metrics and Targets section of the topical ESRS.

Examples:

159. If the undertaking concludes, based on qualitative criteria, that an impact connected to the undertaking is on the edge of the material/non-material border, it may consider:
- a. the amount of water used in production in a particular water-stressed area; or
 - b. the number of people possibly affected in a community where it has a production site.

FAQ 12: Is it necessary to “consolidate/aggregate” the impact and the financial dimensions of a sustainability matter to assess its materiality?

160. No.
161. Despite that impact and financial materiality are inter-related and that the interdependencies between the two dimensions shall be considered (see ESRS 1 chapter 3.3. Double materiality), it is sufficient that a sustainability matter is material from one of the two dimensions to be treated as a material sustainability matter for reporting purposes.
162. If there is a relationship on a given sub-sub-topic between a current negative impact and risks in the medium- or long-term, ESRS 2 SBM 3 requires providing a description of the impact on one hand, and of the risks on the other hand.

FAQ 13: Should the materiality assessment be documented/evidenced? And, if so, how?

163. ESRS do not prescribe a specific documentation, however it is reasonable to expect a certain level of documentation to be produced for internal purposes, such as to inform those in charge of the governance over the process of sustainability reporting (see ESRS 2 GOV- 5), in order to be able to prepare the disclosure prescribed by ESRS 1 IRO-1 and to allow assurance providers to perform their work.
164. 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 also to the level of assurance related to the sustainability reporting (in particular, Art 34).
165. In this regard, EFRAG is the technical advisor to the European Commission for the content of the management report as it develops the draft ESRS; however, the EFRAG’s mandate does not cover the advice on assurance requirements. The documentation and level of evidence supporting the materiality assessment (i.e., ESRS 2 IRO- 1 and 2 and ESRS SBM-3) is outside the remit of the ESRS.
166. It is worthwhile to note that the Accounting Directive requires an assurance provider to “express an opinion based on a limited assurance engagement as regards the compliance of the sustainability reporting adopted pursuant to Article 29b or Article 29c, i.e. the sustainability



reporting prepared using ESRS] including ... the process carried out by the undertaking to identify the information reported pursuant to those sustainability reporting standards, ..." (see Article 34 (aa) of Directive 2013/34/EU added by the CSRD).

FAQ 14: How to do the materiality assessment in diversified undertakings that operate different businesses?

167. ESRS do not prescribe a specific process for the Materiality Assessment (MA). There is no one process for the materiality assessment that fits all undertakings, including diverse or multiple global undertakings.
168. A parent undertaking of a large group (according to CSRD art. 29a) has to disclose in its consolidated sustainability statement the group's impacts, risks and opportunities. For this purpose, the parent undertaking (as defined in ESRS 1 chapter 7.6) is to perform its materiality assessment for the consolidated group, irrespective of its group legal structure.
169. The parent undertaking may perform its materiality assessment using different approaches. As an illustration, two possible approaches could be:
 - a. top-down approach, with an assessment at group level with engagement or consultation with the subsidiaries for specific matters; or
 - b. bottom-up approach, involving the subsidiaries and consolidate the results.
170. In defining the thresholds (see step C in chapter 4.3), the parent undertaking of a large group which operates in different sectors, has to consider an appropriate level of consistency in scoring methodologies and in defining the thresholds (as defined in ESRS 1 chapter 3) across its group.
171. As part of its initial assessment (see Step A in chapter 4.1), the undertaking can consider impacts, risks and opportunities (or alternatively subtopics) commonly associated with its sectors, geographic locations, or with a specific subsidiary of the undertaking's organisation and define its perimeter.

FAQ 15: Will the implementation of sector-specific standards create any new sub-topics or sub-sub-topics to be considered in the materiality assessment?

172. Yes, this could be the case. The sector-specific standards represent another layer built upon the sector-agnostic standards and complement those in terms of depth for a given sub-sub-topic or can, when appropriate, add sub-sub-topics.
173. The intention is to achieve a consistent architecture between both sets of standards. The sector specific standards will provide a list and description of sustainability matters (namely at sub-sub-topic level) that are common in the sector and built upon ESRS 1 paragraph AR 16.
174. As a temporary measure whilst sector-specific standards have not been adopted, the undertaking shall make use of the Transitional provisions (see ESRS 1 chapter 10.1) related to entity-specific disclosures for material sector-specific matters not covered by a sector-agnostic standards or covered with insufficient granularity.



6.4 FAQ on stakeholder engagement

FAQ 16: Do ESRS mandate to actively engage in dialogue with stakeholders for reporting purposes?

- 175. ESRS require disclosure on the materiality process and its outcome but do not mandate specific behaviour on stakeholder engagement or the broader due diligence process.
- 176. However, ESRS 1 paragraph 45 emphasises how the impact materiality assessment is informed by the undertaking's due diligence process. In addition, ESRS 1 paragraph 24 points to stakeholders' engagement as central to the materiality assessment. Engagement with stakeholders is, first, a tool that supports the undertaking's business processes as well as the management of sustainability matters. The undertaking in its preparation of the sustainability statement will be able to leverage the stakeholder's engagement put in place in the context of the due diligence process.
- 177. Stakeholder engagement should inform the identification and assessment of material impacts (see step A in chapter 4.1). It is generally beneficial if the analysis of the undertaking's actual and potential impacts is mature and granular enough to result in a meaningful level of engagement when assessing the impacts. This can help in the assessment of the scale and time horizons and also help to ensure the completeness of the material impacts identified.

FAQ 17: Should all the categories of stakeholders be considered or can the undertaking prioritise some of them? On which basis?

- 178. Stakeholder engagement helps the undertaking to understand which sustainability matters are sources of concern for the respective stakeholders and how they are affected, and this information is useful input to the materiality assessment. The undertaking is not expected to engage or dialogue with stakeholders that are not affected stakeholders for the sustainability matter in question.
- 179. 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 stakeholder (or relevant stakeholders in international instruments) rests on the idea that adverse impacts on people or the environment are related to the degree of affection on stakeholders including stakeholders who cannot raise their concerns (also referred to as silent stakeholders, see ESRS 1, paragraph AR 7).
- 180. It is not necessary to engage with stakeholders that are not affected but, if not obvious, it might be necessary to have a dialogue with stakeholders or representatives to determine whether they are affected or not.

FAQ 18: How to involve/consult stakeholders?

- 181. ESRS do not prescribe how to involve/consult stakeholders (including stakeholder who cannot voice their concerns, see FAQ 16 *Do ESRS mandate to actively engage in dialogue with stakeholders?*).



182. AA1000 Stakeholder Engagement Standard⁶ describes possible methods of engagement depending on the level of engagement of the respective stakeholders:

LEVEL OF ENGAGEMENT	POSSIBLE METHODS OF ENGAGEMENT
Remain Passive <i>No active communication</i>	<ul style="list-style-type: none"> • Stakeholder concern expressed through protest • Letters • Media • Websites etc.
Monitor <i>One-way communication: stakeholder to organisation</i>	<ul style="list-style-type: none"> • Media and internet tracking. • Second-hand reports from other stakeholders possibly via targeted interviews.
Advocate <i>One-way communication: organisation to stakeholder</i>	<ul style="list-style-type: none"> • Pressure on regulatory bodies • Other advocacy efforts through social media • Lobbying efforts
Inform <i>One-way communication: organisation to stakeholder, there is no invitation to reply</i>	<ul style="list-style-type: none"> • Bulletins and letters • Brochures • Reports and websites • Speeches, conference and public presentations
Transact <i>Limited two-way engagement: setting and monitoring performance according to terms of contract</i>	<ul style="list-style-type: none"> • 'Public- Private partnerships' • Private Finance Initiatives • Grant-making • Cause-related marketing
Consult <i>Limited two-way engagement: organisation asks questions, stakeholders answer</i>	<ul style="list-style-type: none"> • Surveys • Focus groups • Meetings with selected stakeholder/s • Public meetings • Workshops
Negotiate <i>Limited two-way engagement: discuss a specific issue or range of issues with the objective of reaching consensus</i>	<ul style="list-style-type: none"> • Collective bargaining with workers through their trade unions
Involve <i>Two-way or multi-way engagement: learning on all sides but stakeholders and organisation act independently</i>	<ul style="list-style-type: none"> • Multi-stakeholder forums • Advisory panels • Consensus building processes • Participatory decision-making processes • Focus groups • Online engagement tools
Collaborate <i>Two-way or multi-way engagement: joint learning, decision making and actions</i>	<ul style="list-style-type: none"> • Joint projects • Joint ventures • Partnerships • Multi-stakeholder initiatives • Online collaborative platforms
Empower <i>New forms of accountability; decisions delegated to stakeholders; stakeholders play a role in shaping organisational agendas</i>	<ul style="list-style-type: none"> • Integration of stakeholders into governance, strategy and operations of the organisation

FAQ 19: What is the role of silent stakeholders and how to engage with them?

183. There might be stakeholders who cannot voice their concerns. For instance nature has been identified as a silent stakeholder (see in ESRS 1 paragraph AR 7).
184. Examples of how to engage with silent stakeholders could be :
- a. Identifying the silent stakeholders that are likely to be impacted by the undertaking's activities, and consider the actual and potential impacts of the undertaking associated with each of them;
 - b. Conducting research to better understand the impacts that affect or could affect these stakeholders through reviewing scientific studies, articles, environmental impact assessments, and other relevant bibliographic documents;
 - c. Using proxies such as organisations that are legitimate representatives or are considered by the undertaking to appropriately represent the stakeholder of for example carbon footprint analysis, water footprint analysis, habitat mapping, and soil assessment to estimate the actual and potential impacts of the undertaking on stakeholders; and
 - d. Testing the results of the estimated potential impacts based on experts' consultation, collaborative partnership with NGOs, and other stakeholders' engagement.

6.5 FAQ on aggregation / disaggregation

FAQ 20: Does the undertaking use the same level of disaggregation across all the impacts, risks and opportunities?

185. No. The disaggregation of reported information on material impacts should fairly reflect the severity of actual impacts or the severity and likelihood of potential impacts. For risks and opportunities, it should reflect the magnitude of current financial effects and the magnitude and likelihood of anticipated financial effects. The principle to follow is to avoid obscuring the specificity and context necessary to interpret the information and to avoid aggregating material items that differ in nature as specified by 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 would obscure material information about impacts, risks or opportunities;
 - b. or by significant site or by significant asset, when material impacts, risks and opportunities are highly dependent on a specific location or asset."
186. 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 and, in this way, provide the most accurate and truthful representation when disclosing the severity of the related impact. The question of how data should be disaggregated should focus on the specific facts and circumstances of the undertaking where the actual or potential negative impacts occur. Hence,



there are situations whereby the undertaking adopts a different level of disaggregation for two separate sustainability matters within the same topic (e.g., own workforce for adequate wages and training and development) and this would be appropriate.

187. As described in ESRS 1 para 55, in preparing the disclosure the undertaking shall consider the level of disaggregation adopted in its materiality assessment.

Examples:

188. For example, for water usage a criterion for disaggregation could be based on the vulnerability to water-stress by geographical area or site. However, in the case of collective bargaining, disaggregation at country level is more appropriate, as laws and regulations and labour market practices vary at that level.
189. An undertaking in the garment industry manufactures in its subsidiaries in different countries where decent working conditions and adequate wages are not a particular pertinent challenge. However, if there is one site, for example in a country, where its subsidiary does pay below the adequate wages for the country, the materiality assessment should be performed at that level of disaggregation to identify material negative impact. Similar disaggregation might be necessary 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 to others.

FAQ 21: Is an IFRS or local GAAP segment an appropriate level of disaggregation for the materiality assessment?

190. In general no. The disaggregation objectives for financial reporting and sustainability reporting are not the same in terms of content or time horizons.
191. Segment reporting under IFRS or local GAAP is based on a “management approach” (as defined in the IFRS) or based on another approach as the case might be for the segment reporting required under local GAAP. The criterion for financial reporting segmentation groups business activities or, in some cases, subsidiaries into segments that are as much as possible homogenous within the segment and non-homogenous as compared to the remaining segments from a financial reporting perspective. The level of disaggregation or reportable segments are consistently applied in the financial reporting without variation between the different reported items.
192. The disaggregation for financial reporting segments is designed for a different purpose and in general is not appropriate to reflect the significant material impacts, risks and opportunities across the undertaking. The appropriate disaggregation unit may be a country, site, or significant asset when material impacts, risks and opportunities are linked to a country, specific location or asset. In addition, the level of disaggregation should reflect the nature of the different sub-topics and, and as such, should be adjusted from one sub-topic to another when this is necessary to properly portray the material impacts, risks and opportunities (see ESRS 1 paragraph 54).
193. Therefore, a disaggregation following the segments used for financial reporting may not be granular enough or relevant for sustainability reporting⁷.

⁷ ESRS 1 SBM 1 requires the identification of the ESRS sectors in which the undertaking operates (ESRS 2 paragraph b) and c)) and requires to disclose the revenues by ESRS sectors. EFRAG will consult in the last quarter of 2023 or in



Example:

194. A multinational group that prepares consolidated accounts has established that its segment reporting for financial reporting is based on products and services offered worldwide.
195. When performing its sustainability materiality assessment on the environmental topic of water, the undertaking determines that the material negative impacts are correlated to the levels of water stress in the geographical areas where the factories are located. Therefore, it identifies that the disaggregation is to be performed at geographical level and conclude that the financial reporting segments are not appropriate.

6.6 FAQ on reporting

FAQ 22: Do ESRS require to disclose severity, scale, scope, and irremediable character of material impacts, respectively likelihood of occurrence and potential magnitude of material risks and opportunities?

196. No. ESRS do not require to disclose those criteria in the undertaking's sustainability statement. The undertaking has to report on the processes to identify and assess material impacts, risks and opportunities as required by ESRS 2 IRO-1 and on the outcome as required by ESRS 2 SBM-3 and IRO-2.
197. As reported in FAQ 13 *Should the materiality assessment be documented/evidenced? And, if so, how?*, ESRS do not prescribe a specific documentation, however it is reasonable to expect a certain level of documentation to be produced for internal purposes and for the auditors within the assurance engagement on the undertaking's sustainability statement.
198. The necessary documentation can also include a description of severity, scale, scope, and irremediable character of material impacts, respectively likelihood of occurrence and potential magnitude of material risks and opportunities. This documentation can help the undertaking's management and the auditor (i.e. as an audit evidence) to better understand the materiality assessment process and the related results.

FAQ 23: If a matter is material from the financial (or impact) perspective only, shall disclosures cover all the requirements, or only information about financial (or impact) materiality?

199. Information about metrics may be limited to information that is relevant under the financial (or impact) materiality perspective only when the undertaking decides to omit disclosure requirements or datapoints that it has assessed to be not material⁸.

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.

8 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).

200. When a matter is assessed to be material from the financial (or impact) perspective only:
- a. the information about policies, actions and targets shall cover all the datapoints in the minimum disclosure requirements⁹ and the topical standards (ESRS 1 paragraph 33). The level of detail of such information (as in general for narrative information) will reflect the general approach to information materiality (ESRS 1 paragraph 31) but the reported information should not be limited to financial or impact perspective only; and
 - b. the information about metrics will reflect the assessment of materiality of the information required by the corresponding requirements in the topical standards (ESRS 1 paragraph 34), which is performed adopting the criteria in ESRS 1 paragraph 31. In such assessment, the undertaking considers the capacity of the information to meet the users' decision-making needs and may conclude that a disclosure requirement or a datapoint is not material, and therefore omit it. Accordingly, it might be the case that for a matter material from the financial (or impact) perspective only, the undertaking may conclude that a metrics related to the impact (or financial) perspective only can be omitted.
201. It is also important to note that impact information is of interest for investors when a matter is financially material. Similarly, financial information is relevant for other stakeholders when a matter is material from the impact perspective, as it supports accountability.

FAQ 24: Is a group active in different sectors required to include data for the entire group in the metrics or only data for the entities/sectors of the group related to the material impact, risk or opportunity?

202. Data for the entire group shall be included in the metrics, except for when specified differently in sector-agnostic topical or sector-specific standards
203. 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. For the assessment of material impacts, risks and opportunities, ESRS 1 clarifies that it is performed "*for the entire consolidated group, regardless of its group legal structure*" (ESRS 1 paragraph 102). The group legal structure is also irrelevant for reporting on metrics, as it cannot make a difference whether an undertaking is doing its business activities using multiple legal entities as a group or is organised doing the same business activities using only one legal entity.
204. However, ESRS 1 also stipulates that, "(w)hen 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" (ESRS 1 paragraph 57).
205. Disclosure regarding impact, risk and opportunity 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 impact, risk and opportunity, when appropriate.

⁹ 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*.

206. In addition, ESRS 1 also stipulates for the level of disaggregation that “when needed for a proper understanding of its material impacts, risks and opportunities, the undertaking shall disaggregate the reported information ...” (ESRS 1 paragraph 54).

Example:

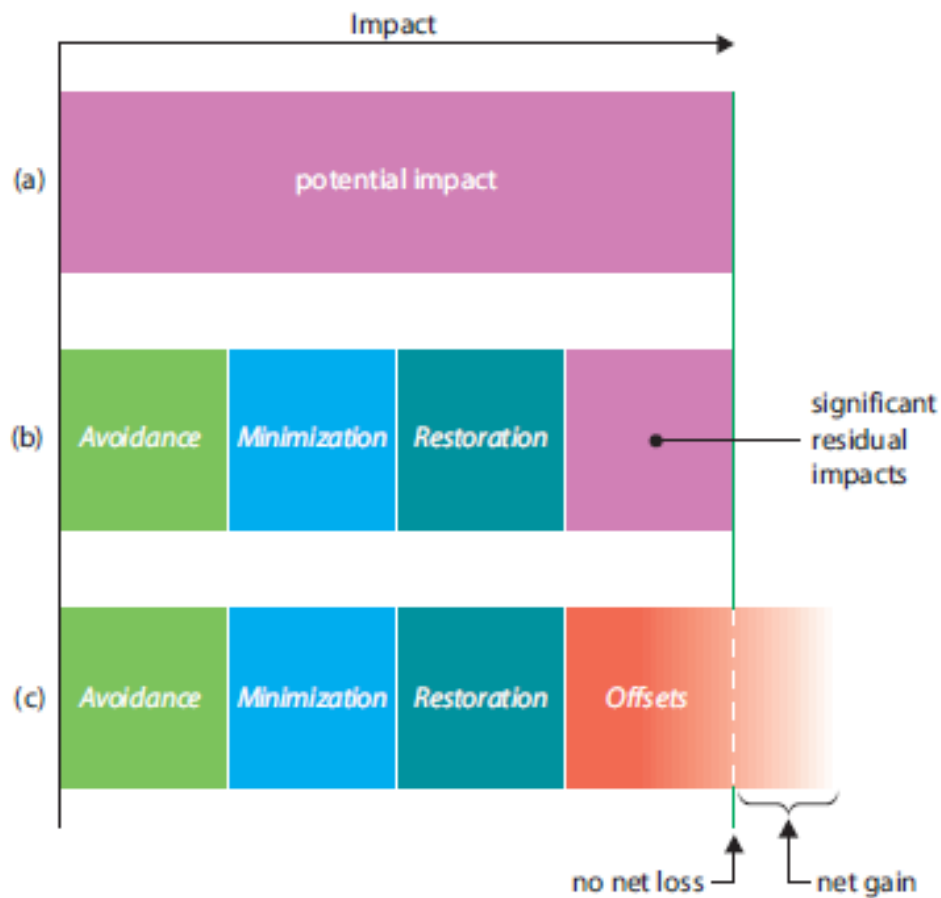
207. Assume Group is active in sector A and B, respectively with two subsidiaries A and B. Group has a material impact, risk or opportunity in relation to water consumption. However, the impact, risk or opportunity is only material for sector A, respectively subsidiary A.
208. ESRS E3-4 requires that:
- a. total water consumption in m³ is disclosed for own operations, so this shall be for the entire Group (ESRS E3 paragraph 28 (a), same for paragraph 28 (c) total water recycled and reused and paragraph 28 (d) total water stored and changes in the storage); and
 - b. total water consumption in areas at water risks (ESRS E3 paragraph 28 (b)) would depending on the areas at water risks only relate to sector A, respectively subsidiary A.
209. According to ESRS E3-1, the undertaking shall describe its policies that address the management of its material impacts, risks and opportunities related to water and marine resources. As water consumption is only material for sector A, subsidiary A will have put in place appropriate policies and the disclosure would cover them. Similarly, it would be appropriate to only disclose on actions and targets for sector A, respectively subsidiary A, if actions are taken and targets are set at that level.

FAQ 25: When an undertaking has already put in place actions to avoid, minimise, mitigate or rehabilitate impacts, shall it nevertheless report on the impacts before those actions?

210. Yes. The undertaking has to report the material impact irrespective of the actions implemented to avoid, minimize, mitigate or rehabilitate it (see point (a) in the figure below).
211. In addition, the undertaking can include a description of the actions taken (according to the mitigation hierarchy) and the effects on the impact in terms of severity and likelihood.



Figure 6: Impacts, residual impacts and net loss/gain¹⁰



212. As defined by the CSBI (CSBI, 2013a), the mitigation hierarchy is:
- "the sequence of actions to anticipate and avoid impacts on biodiversity and ecosystem services; and
 - where avoidance is not possible, minimize; and,
 - when impacts occur, rehabilitate, or restore; and
 - where significant residual impacts remain, offset."
213. Restoration and offsetting actions begin once impacts have already occurred. In these cases, the undertaking has nevertheless to report on the impacts before those actions, describing the concrete effects of the actions on the impacts.

Examples:

214. An undertaking active in the mining sector has planned to open a new site in a region with valuable natural habitats for some species protected under national laws. The undertaking worked with biodiversity experts to evaluate the potential impacts of its planned activity in this region. The analysis identified areas where the undertaking activity can create material negative potential impacts on biodiversity. The undertaking has identified areas where it needs

¹⁰ Source: A cross-sector guide for implementing the Mitigation Hierarchy – Cross Sector Biodiversity Initiative (CSBI) pg. 12).

to avoid future development and areas where efforts to mitigate impacts on species and habitats can have the greatest benefits. Based on this information, the undertaking has defined the Wildlife Mitigation Plan to preserve existing habitats and to offset any loss of habitat by taking steps to restore or enhance habitat conditions nearby. When defining its sustainability statement, the undertaking has to disclose its material potential negative impact on biodiversity, adding information on the actions implemented to avoid and mitigate it (i.e. describing its Wildlife Mitigation Plan).

215. An undertaking active in the oil & gas sector has a big onshore oil field in a biodiversity-rich area. Low-intensity mixed farming is the main land use on the valley bottom and lower slopes, giving way to natural grassland, woodland- and rocky habitats at higher elevations. The onshore oil field construction has caused important effects on biodiversity, in particular on forest and upland grassland, with implication also on the farming activities. The outcome was a targeted biodiversity action plan for impact restoration and long-term monitoring, which has been implemented in the site. Several key approaches were adopted to restore pipeline and flowline disturbances: 1) directly re-seeding with locally sourced seeds; 2) spreading seed-rich grass cuttings from the undisturbed area. The monitoring activity showed that the prairies had recovered their original structure, composition and ecological functions, without any increase in non-native species. In this case the undertaking has nevertheless report on the impacts caused by the oil field on biodiversity before the restoration activities, describing the results obtained through the aforementioned actions.

FAQ 26: Shall the undertaking report also on material matters that have not been managed and/or for which there are no actions?

216. Yes. The materiality assessment is performed by the undertaking to identify the material impacts, risks and opportunities to be reported, which are classified into ESG topics, sub-topics or sub-sub-topics (also referred as "matters").
217. ESRS 1 paragraph 33 establishes that for the material impacts, risks or opportunities identified, the undertaking is to disclose its policies, actions and targets to manage those. And it 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 5.

Example:

218. An undertaking in the hotel services sector has identified training and development on health and safety as a material impact. However, it does not have a formal training policy or actions related to this matter. In this case, health and safety training is a material matter which is disclosed by the undertaking together with the fact that there are no policies or actions at the end of the reporting year, but the undertaking may disclose that they are working on drafting and implementing such policies and actions in the future.

FAQ 27: Is there a recommended format or matrix to graphically present the material matters?

219. ESRS do not mandate a specific format or matrix to present or visualise the material matters. Given the wide scope of ESRS 2 SBM-3, which lays out the general requirements of reporting



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on material impacts, risks, and opportunities, it may be feasible to present only certain aspects of these requirements in a visual matrix.

220. The following approaches are examples of possible formats of visualisation, each highlighting certain aspects of the double materiality assessment:
- a. a graph that presents "impact materiality" on one axis and "financial materiality" on the other axis, thereby outlining for each material matters its weight for the two dimensions of double materiality;
 - b. going a step further, a more detailed option may be to use two separate graphs for (1) impact materiality and (2) financial materiality and present material matters according to "IRO Timeline" (on the x-axis) and "Magnitude of IRO" (y-axis), thus incorporating time horizons to the visualisation;
 - c. same as in b, but with a single graph that combines the outcome of the two perspectives (impact and financial materiality) in a single graph;
 - d. a graph that portrays "Likelihood of IRO" on the x-axis and the "Magnitude of IRO" on the y-axis. This graph may also visualize a threshold that will position material matters above a certain cut-off point (easily displayed by a line, or by the upper corner of the graph); and
 - e. tables are also a way to present the many disclosures required for each material matters. Pictograms can be used in the different columns of the table to help visualize the information (e.g. where the impacts / risk is concentrated in the value chain, whether the matter is financially material, material from the impact perspective, or both,).
221. To provide a more comprehensive overview of the outcome of the double materiality assessment, it is also possible to use several different visualisations.



Subject to change

