



IMPLEMENTATION GUIDANCE

DRAFT EFRAG IG 1
Materiality
Assessment

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sustainability reporting

Disclaimer

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This implementation guidance has been developed for use by large listed and unlisted companies that are subject to ESRS. It is therefore not intended for use by non-listed small and medium-sized enterprises (SMEs), which may use the future Voluntary SME standard.

This implementation guidance relates to the sector-agnostic ESRS as adopted by the European Commission on 31 July 2023. Sector-specific standards may add sector specifications to be followed by specific sectors.

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Summary in 13 key points

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



referenced in the CSRD. This entails seeking input and feedback to understand concerns and evidence about actual and potential impacts of the undertaking on people and the environment. It also helps to substantiate the importance of the sustainability matters from the perspectives of the affected stakeholder groups. However, the ESRS do not mandate specific behaviour on stakeholder engagement and do not pre-empt the content of the CSDDD currently under definition in the EU legislative process.

8. The undertaking assesses the materiality of impacts for reporting purposes against criteria of severity and likelihood. This also includes setting appropriate quantitative and/or qualitative thresholds for reporting purposes. Severity is based on the scale, scope and irremediable character of negative impacts and the scale and scope of positive impacts.
9. Material risks and opportunities for the undertaking generally derive either from impacts or from dependencies and other risk factors. Undertakings assess materiality of its risks and opportunities based on appropriate quantitative and/or qualitative thresholds related to anticipated financial effects on performance, financial position cash flows and access to finance including cost of capital.
10. The due diligence process, per the related international instruments, can help an undertaking both (a) to identify and assess its actual and potential negative impacts, as well as (b) to assess their materiality for reporting purposes based on the criteria of severity and likelihood.
11. When undertakings perform an assessment under the GRI Universal Standards, the GRI assessment constitutes a good basis for the assessment of impacts under the ESRS.
12. An undertaking that applies the ESRS is expected to be able to comply with the identification of the sustainability related information on risks and opportunities under IFRS Sustainability Disclosure Standards (also known as ISBB Standards). This reflects the alignment of the scope of financial materiality in ISSB standards and the ESRS.
13. Following the completion of the materiality assessment process, the undertaking shall disclose:
 - (a) the process to identify and assess its material IROs (ESRS 2 IRO-1),
 - (b) the interaction of its material IROs with its strategy and business model (ESRS 2 SBM-3), and
 - (c) the Disclosure Requirements under the ESRS covered by its sustainability statement (ESRS 2 IRO-2).



1. Introduction

14. The objective of this non-authoritative Guidance is to support the implementation activities of preparers and others using or analysing ESRS reports, with regard to the double materiality assessment (referred to as “materiality assessment” or “assessment” or “MA” in this document). Hence, this Guidance does not introduce new provisions to the ESRS, as these can only result from future standard setting activities (e.g., future possible amendments to draft ESRS) conducted in accordance with the EFRAG due process. When content of this Guidance is seen to contradict the requirements in the ESRS, those requirements prevail.
15. Due to the principles-based nature of the ESRS requirements, also specifically on this topic, there is no single solution for all undertakings in terms of designing processes and adopting methodologies. Hence, this Guidance provides tools and mechanisms for undertakings to comply with the ESRS while taking full account of their specific facts and circumstances (including, their business model, strategy, legal structure, complexity or governance). Therefore, the illustrations of how to apply the criteria in ESRS 1 *General requirements* and ESRS 2 *General disclosures* in this Guidance including examples or visual representations, are not the only possible approaches to implement the ESRS requirements.
16. The content of this document has been developed by EFRAG on the basis of the July 2023 Delegated Act on the ESRS adopted 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”).
17. This Guidance includes FAQs on interoperability with ISSB and GRI Universal Standards, illustrating the interactions of the corresponding materiality concepts and assessment processes when applicable.
18. This Guidance also includes FAQs related to international instruments or reporting standards that will be useful to perform the materiality assessment and that are referenced in the CSRD. In the case of due diligence these are the *Guiding Principles on Business and Human Rights* issued by the United Nations and the *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. This Guidance acknowledges that market practice is currently developing for double materiality assessment and there are still no examples of sustainability statements prepared under the ESRS.

Structure of the guidance

19. The document is organised as follows:
 - (a) chapter 2 explains the ESRS approach to materiality;
 - (b) chapter 3 illustrates how the materiality assessment is performed;
 - (c) chapter 4 explains how undertakings could take account of other frameworks/standards or sources; and
 - (d) chapter 5 complements chapter 2 to 4 with FAQs on:
 - (i) impact materiality;
 - (ii) financial materiality;
 - (iii) the materiality assessment process;



- (iv) stakeholder engagement;
- (v) aggregation / disaggregation; and
- (vi) reporting.

Cross references to the MAIG

20. To avoid duplication and reduce the length of this document, there is significant reference to the [Value Chain Implementation Guidance \(VCIG\)](#) developed by EFRAG. For example, the due diligence aspects related to the materiality assessment (and VC aspects) are covered in that guidance rather than here.
21. Please note that references to the [VCIG are done in this colour](#), whereas references in [green refer to this document](#).

Acronyms used

22. Acronyms used in this document are:

- (a) CSDDD - Corporate Sustainability Due Diligence Directive
- (b) CSRD - Corporate Sustainability Reporting Directive;
- (c) Delegated act - Commission Delegated Regulation supplementing Directive 2013/34/EU as regards sustainability reporting standards;
- (d) DR - disclosure requirement
- (e) ESRS - European Sustainability Reporting Standards;
- (f) GHG - greenhouse gases or the GHG protocol;
- (g) GRI - Global Reporting Initiative;
- (h) IROs - impacts, risks and opportunities;
- (i) ISSB - International Sustainability Standards Board;
- (j) MA - materiality assessment;
- (k) MAIG - the Materiality Assessment Implementation Guidance; and
- (l) OECD MNE: OECD Guidelines for Multinational Enterprises (also referred to as the OECD Guidelines);
- (m) SFDR: Sustainable Finance Disclosure Regulation¹
- (n) UNGP: United Nations Guiding Principles on Business and Human Rights.

Annexes to the delegated act:

[Annex 1](#): ESRS including appendices

[Annex 2](#): Acronyms and glossary of terms

2. The ESRS approach to materiality

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

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

24. Double materiality covers both impact and financial materiality. Impact materiality pertains to the material information about the undertaking's impacts on people or environment related to a sustainability matter; financial materiality pertains to the material information about risks and opportunities related to a sustainability matter. The terms "material" and "materiality" are used throughout the ESRS to refer to double materiality, unless specified otherwise (referred to in this document as "materiality").
25. The identification of the material matters is the starting point to determine the material information to be disclosed in the sustainability statement on material IROs related to those matters. Material IROs related to environmental, social and governance matters that are to be reported are those that arise in the undertaking's own operations, as well as in its the upstream and downstream value chain. By definition, the reporting excludes matters that are not material. If the MA process is not appropriately designed, the undertaking may provide incomplete reporting (with material IROs not being disclosed).
26. If the undertaking identifies a large number of IROs, it may prioritise them for management purposes. However, for reporting purposes this prioritisation should not exclude any material IROs, in particular when the undertaking has not addressed or fully addressed these material IROs through its policies, targets and action plans. This is useful information and so should be included irrespective of whether actions have been undertaken or are planned to address them (refer to ESRS 2 MDR-P, MDR-A and MDR-T).
27. ESRS 1 sets criteria for the materiality assessment, but not specific thresholds to determine when a matter or information is material or not. Therefore, the assessment requires the exercise of judgement. The undertaking needs to set thresholds based on the ESRS 1 criteria, as well as its own specific facts and circumstances. The need for judgement will be higher when the information and evidence about the materiality of a given IRO is inconclusive.
28. The materiality assessment should be based upon supportable evidence and rely to the maximum extent possible on objective information, while implementing the impact materiality and financial materiality criteria specified in the ESRS (ESRS 1 chapters 3.4 and 3.5).
29. The ESRS require undertakings to disclose the materiality assessment process and its outcome. This includes the following information: methodologies and assumptions applied, the focus and extent of the process, as well as inputs. ESRS 2 IRO-1 and IRO-2 also require transparency on the judgement exercised, i.e. quantitative or qualitative thresholds and other criteria used. Refer to [chapters 3.6 Deep dive on impact materiality- Setting thresholds](#) and [3.7 Deep dive on financial materiality- Setting thresholds of this Guidance](#).
30. To meet the required characteristics of quality (Appendix B of ESRS 1), the MA process (including criteria and thresholds applied and conclusions) should be consistent with internal and other external reporting. Consistency with sustainability management policies and actions is also required, including those fulfilling sustainability-related laws and regulations.
31. The undertaking may briefly explain the conclusions of its materiality assessment in relation to any omitted topic or topics. However, the undertaking shall provide explanations if it concludes that it has no material IROs with respect to climate change and therefore omits required disclosures per ESRS E1 Climate Change. The undertaking shall also report on material matters that are not covered or are covered insufficiently in the topical ESRS in the form of entity-specific information (ESRS 1 paragraph 11).
32. Once the undertaking has identified the material matters, it then assesses the information to be reported for each material matter, based on the materiality of information (ESRS 1



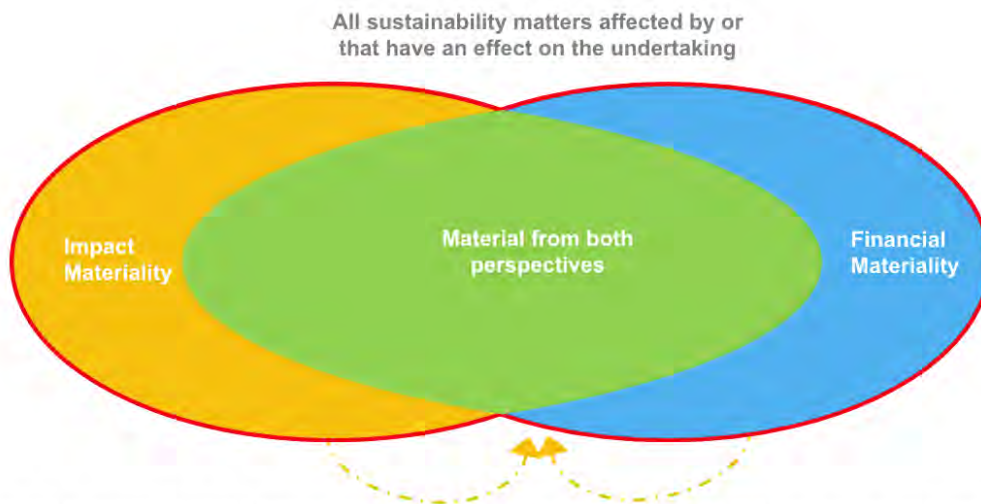
paragraphs 30, 31, 33 and 34). The concept of materiality of information applies to the requirements at a more granular level, i.e., at Disclosure Requirement or datapoint level. Refer to [Chapter 2.3 Criteria to determine the materiality of information](#) and [Chapter 2.4 Scope of application of the materiality of information](#).

2.1 Implementing the concept of double materiality

33. As discussed above, the CSRD requires that sustainability reporting shall be based on double materiality. A sustainability matter can be material from an impact perspective or from a financial perspective or from both (see ESRS 1 chapter 3). Refer to figure 1 a) below.
34. The 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 the 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 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). “The financial materiality assessment corresponds to the identification of information that is considered material for primary users of general-purpose financial reports in making decisions relating to providing resources to the entity. In particular, information is considered material for primary users of general-purpose financial reports if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the undertaking’s sustainability statement” (ESRS 1 paragraph 48). In this document the terms “risks and opportunities” are used to identify the financial risks and opportunities that are in the scope of financial materiality.”
35. Impact materiality and financial materiality are often intertwined (refer to figure 1a) and 1b) below). The undertaking’s impacts on people or the environment, combined with changes to strategy, including investments, as well as management decisions made to address such impacts may give rise to risks and opportunities. Material risks and opportunities generally derive from impacts and dependencies.



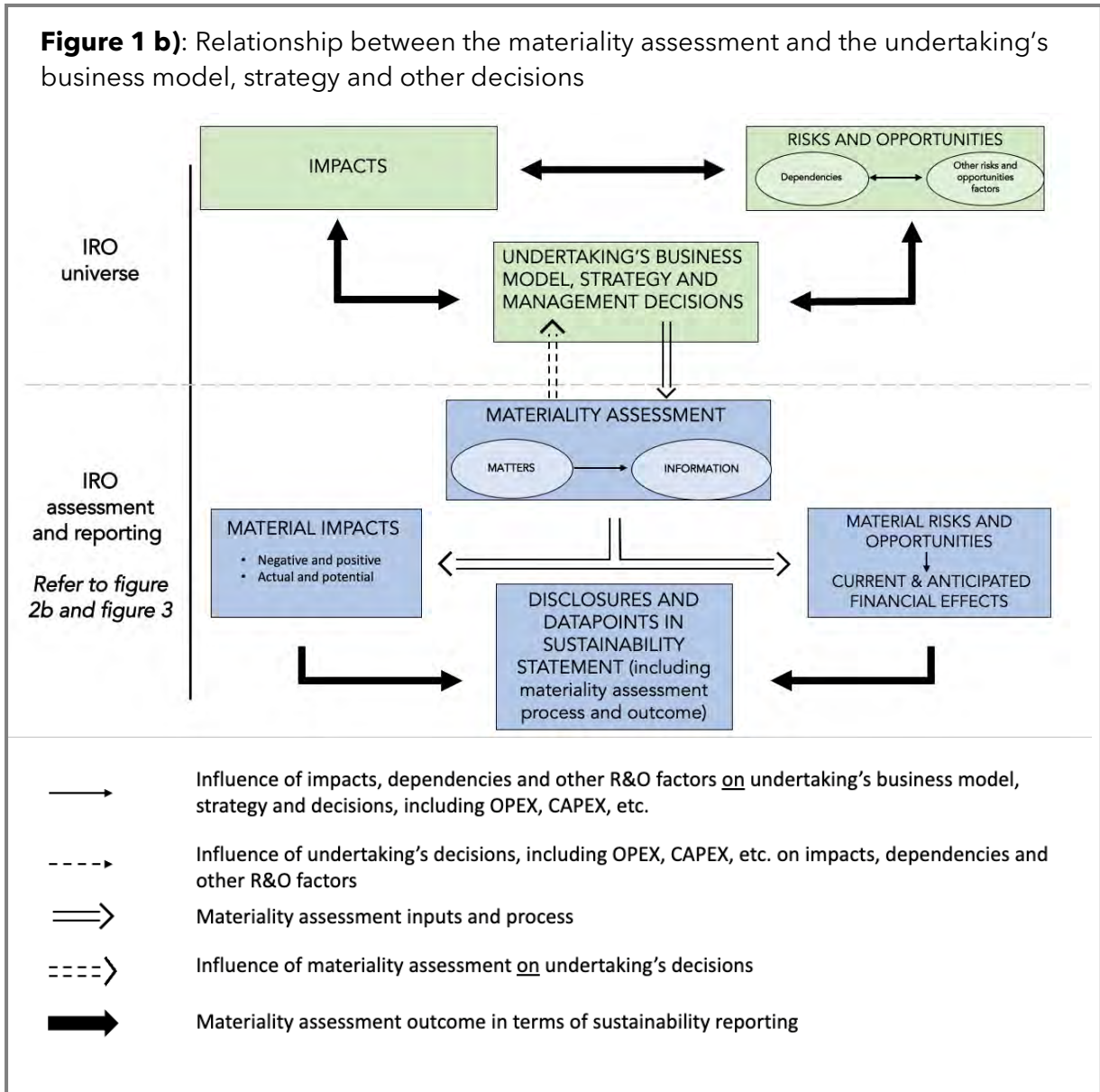
Figure 1 a) Double materiality - the scope is reflected by the red outline

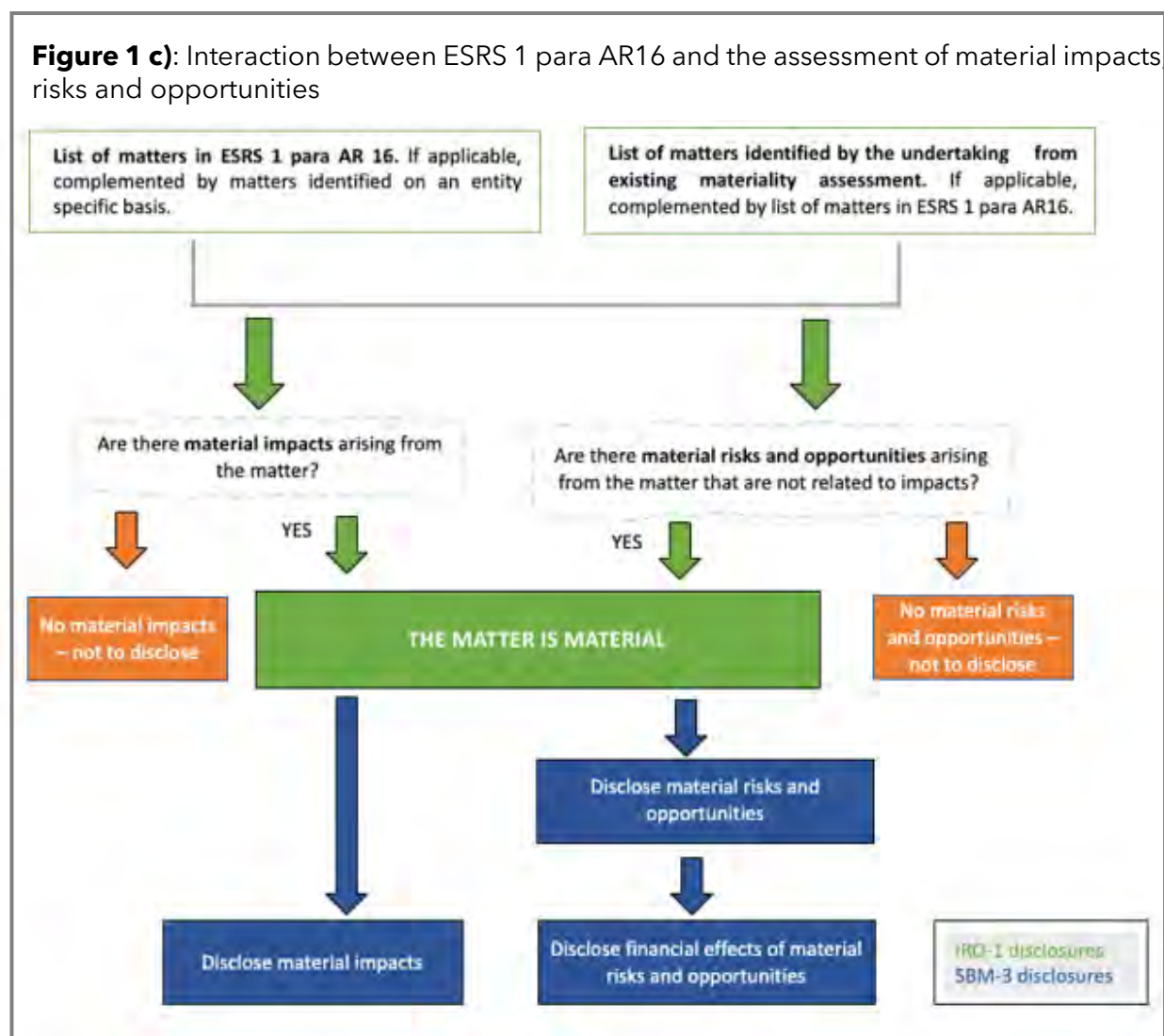


Caveat: for illustration only – the dimensions in the graph do not necessarily represent the expected overlap (green) between financial and impact materiality nor the relative perimeters of impact materiality (orange) versus financial materiality (blue). For most material impacts, a risk or opportunity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



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





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

- (a) Identification of impacts;
- (b) Assessment if such impacts lead to risks and opportunities (refer to paragraph 37 below). This includes but it is not limited to risks and opportunities that derive from dependencies on resources;
- (c) Identification of risks and opportunities not sourced from impacts (refer to paragraph 38 below for examples). This includes but it is not limited to those risks and opportunities that derive from dependencies, where impacts do not affect that resource².

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



37. For most material impacts, a material risk and/or opportunity may emerge over time. For example:

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

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

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

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

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

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

39. Sustainability-related regulatory developments that address systemic risks may affect the prospects of the undertaking's business. For example, risks can arise from changes in the regulatory environment, such as a new pollution abatement legislation which require significant capital expenditure and expose the undertaking to sanctions.

40. Impact and financial materiality are two different concepts, but they are inter-related and the interconnections between them shall be considered. This may require judgement when organising the materiality assessment, including separation or not of the two processes or whether there should be common steps. However, there is merit in

Interaction between impact and financial materiality

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

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

Irrespective of the fact that the matter is material due to its impacts or risks/opportunities, it is only when an undertaking identifies that material risks and/or opportunities exist that the undertaking discloses the financial effects relating to the matter.

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



maximising synergies between the two processes to avoid gaps. The figure 1c) above illustrates the synergies and how ESRS 1 AR 16 is a common denominator for both impact and financial materiality.

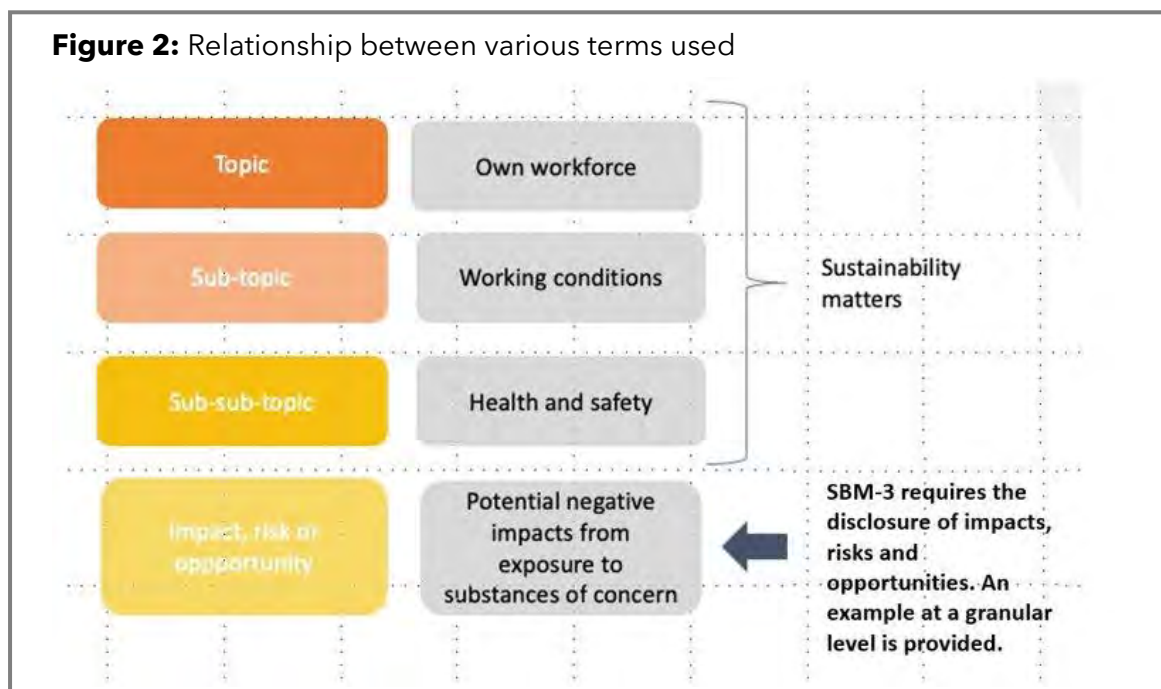
2.2 Understanding key concepts for the materiality assessment

41. Sustainability matters are defined in the Annex 2 of the delegated act 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).
42. The level of granularity of the matters to be considered ranges from topic to sub-topic level and, in some cases, to sub-sub-topic level. The following table is an extract from ESRS 1 AR 16 and sets out the relationship between topics, sub-topics, and sub-sub-topics (also refer to Figure 3 below).

| Standard | Topic | Sub-topic | Sub-sub-topic |
|----------------|----------------------------|---|--|
| ESRS E3 | Water and marine resources | <ul style="list-style-type: none"> • Water • Marine resources | <ul style="list-style-type: none"> • Water consumption • Water withdrawals • Water discharges |
| ESRS S1 | Own workforce | Other work-related rights | <ul style="list-style-type: none"> • Child labour • Forced labour • Adequate housing • Privacy |
| ESRS G1 | Business conduct | Corruption and bribery | <ul style="list-style-type: none"> • Prevention and detection • Incidents |

43. As described in ESRS 1 paragraph 8, the three levels of granularity (i.e., topics, sub-topics and sub-sub-topics) are collectively called sustainability matters. To recap:
- the goal of the assessment is to identify the material IROs related to matters to be reported (ESRS 2 SBM 3);
 - the matter is assessed as material when material impacts and/or material risks or opportunities arise from it (ESRS 1 paragraph 43 and 49); and
 - 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).
44. The undertaking shall disclose its material IROs, which are in turn mapped to sustainability matters (i.e., topics, sub-topics or sub-sub-topics). In preparing its disclosure according to ESRS 2 SBM-3, the aggregation rules defined in ESRS 1 chapter 3.7 also apply, the undertaking may aggregate information to the extent that it does not obscure material content (ESRS 1 chapter 3.7). Refer to Figure 2 below.





45. The undertaking needs to identify whether a topic, sub-topic or sub-sub-topic is material from any of the two perspectives because the matter is associated with an identified material impact, risk or opportunity or both.
46. Once a matter has been identified as material, the undertaking refers to the DR in the respective topical ESRS to identify the information to be disclosed on the matter (ESRS 1 paragraphs 30 and 31). For example, if an undertaking concludes that health and safety of its own workforce is material due to the employees' exposure to harmful chemical substances, it shall provide the required information. This includes the disclosure requirements in ESRS S1-1 *Policies*, S1-4 *Taking action*, S1-5 *Targets*, and S1-14 *Health and safety metrics*. Similarly, if an undertaking concludes that pollution of water is material, it shall provide information under the DR in ESRS E2-1 *Policies*, E2-2 *Actions and resources*, E2-3 *Targets*, E2-4 *Pollution of air, water and soil* and E2-6 *Anticipated financial effects from material polluted-related risks and opportunities*.
47. In addition, as specified in paragraph 31, in some situations where a sustainability matter is identified as material but is not covered by an ESRS (see ESRS 1 paragraph AR 16 for a full list of matters) or is not covered with sufficient granularity, the undertaking shall provide additional entity-specific disclosures (ESRS 1 paragraph 11).
48. In summary, once a given matter is assessed to be material, the information to be disclosed is identified at matter level, following the datapoints of the relevant DR in the topical standards. However, the outcome of the materiality assessment (ESRS 2 SBM-3) is to be disclosed at the level of impacts, risks and opportunities (or groups of them).

2.3 Criteria to determine the materiality of information

49. Determining the materiality of information is a step that follows the MA leading to the identification of material matters to be reported on (see [chapter 3 Materiality assessment-how is it performed?](#)) and it is applied at the more granular level of DRs or datapoints. ESRS 1 paragraphs 31, 33-35 set requirements on how to assess materiality of information.



50. The criteria to determine the materiality of information are based on relevance (ESRS 1 paragraph 31): (a) the significance of the information in relation to the matter it depicts or its (b) decision-usefulness. This is relevant for the primary users of general-purpose financial information (i.e., financial materiality focused) and/or for other users whose interest is on the undertaking's impacts (i.e., impact materiality). In practice, information that is relevant under perspective (b) (decision-usefulness) is in most cases also relevant under perspective (a) (significance). However, there could be cases where a piece of information is significant to depict the impacts of the undertaking on people or the environment, without necessarily being a relevant input for the users of the sustainability statement in its decision-making. When a matter is material from both an impact and a financial perspective, the information needs of the two groups of users (investors and others) will highly likely be the same in practice. In other cases, the information may differ (refer to [FAQ 21](#) *If a matter is material from the financial (or impact) perspective only, should disclosures cover all the requirements, or only information about the relevant perspective?*).
51. In addition, the undertaking needs to apply the general requirements on fundamental qualitative characteristics of information (relevance and faithful representation) and the enhancing qualitative characteristics of information (comparability, verifiability and understandability) (ESRS 1 Appendix B).
52. ESRS 2 IRO-2 requires an explanation of the determination of the information to be disclosed in relation to the material IROs (i.e., materiality of information), including the use of thresholds and/or how it has implemented the criteria in ESRS 1 chapter 3.2 *Material matters and materiality of information*.

2.4 Scope of application of the materiality of information

53. 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.
54. The determination of the information to be reported for policies, actions and targets in relation to a material matter is set out in the list of Minimum Disclosure Requirements on policies, actions, and targets (see chapter 4.2 *Minimum Disclosure Requirements on policies and actions* and chapter 5 *Metrics and targets* in ESRS 2). The datapoints in the Minimum Disclosure Requirements depict the relevant information to a user to assess the policies, actions and targets in relation to a material matter. In addition, filter of materiality of information (ESRS 1 para 31) is applied in determining the granularity of the description of the policies, actions and targets. If the undertaking has not adopted policies, actions or targets to manage a given material matter, it has to state this, but no additional information is required. There is also a voluntary disclosure on the timeline to adopt such policies, actions or targets. (ESRS 1 paragraph 33). Reporting that the undertaking does not have policies, actions or targets for a material matter is per se a material piece of information, even if no other information is required.
55. The determination of metrics information to be reported is informed by the assessment of material information (*shall include* the information assessed to be material, ESRS 1 paragraph 34). This is performed starting at the level of the DR, and secondly at the level of the related datapoints located either in the DR³ or, when applicable, in Application Requirements. When the information required by a DR or a datapoint is assessed to be not

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



material (per ESRS 1 paragraph 31), and for datapoints not needed to meet the objective of the Disclosure Requirement, the undertaking *may omit* such information (ESRS 1 paragraph 34).

56. The criteria to determine the materiality of information (ESRS 1 paragraph 31) are also expected to support the determination of entity-specific disclosures (ESRS 1 paragraph 30 b) and ESRS 1 paragraph 11 and paragraphs AR 1-5). This ensures that entity-specific disclosures meet the qualitative characteristics of information and include all material information.
57. The DRs and datapoints in ESRS 2 are to be reported irrespective of the outcome of the materiality assessment. In this case, the criteria to assess the materiality of information (ESRS 1 paragraph 31) are expected to support the determination of the level of detail of narrative disclosure that is necessary to meet the Disclosure Requirements in ESRS 2 (ESRS 1 paragraph 31 refer to the '*applicable information*').

2.5 Datapoints derived from EU legislation

58. When the undertaking omits a datapoint derived from other EU legislation listed in ESRS 2 Appendix B *List of datapoints in cross-cutting and topical standards that derive from other EU legislation* because it is not material, the undertaking has to include an explicit statement that such 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 *List of datapoints in cross-cutting and topical standards that derive from other EU legislation*. Such table shall specify where the datapoints can be found in the statement and for those that are omitted as not material, report that the respective datapoint is not material.
59. These datapoints are treated similarly to other datapoints for the purpose of assessing the information to be reported on a material matter, i.e., those related to policies, targets and actions follow ESRS 1 paragraph 33, and those related to metrics are omitted if not material (ESRS 1 paragraph 34).

2.6 Considerations for upstream/downstream value chain

60. The materiality assessment is also used to identify material IROs 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](#)).

3. How is the materiality assessment performed?

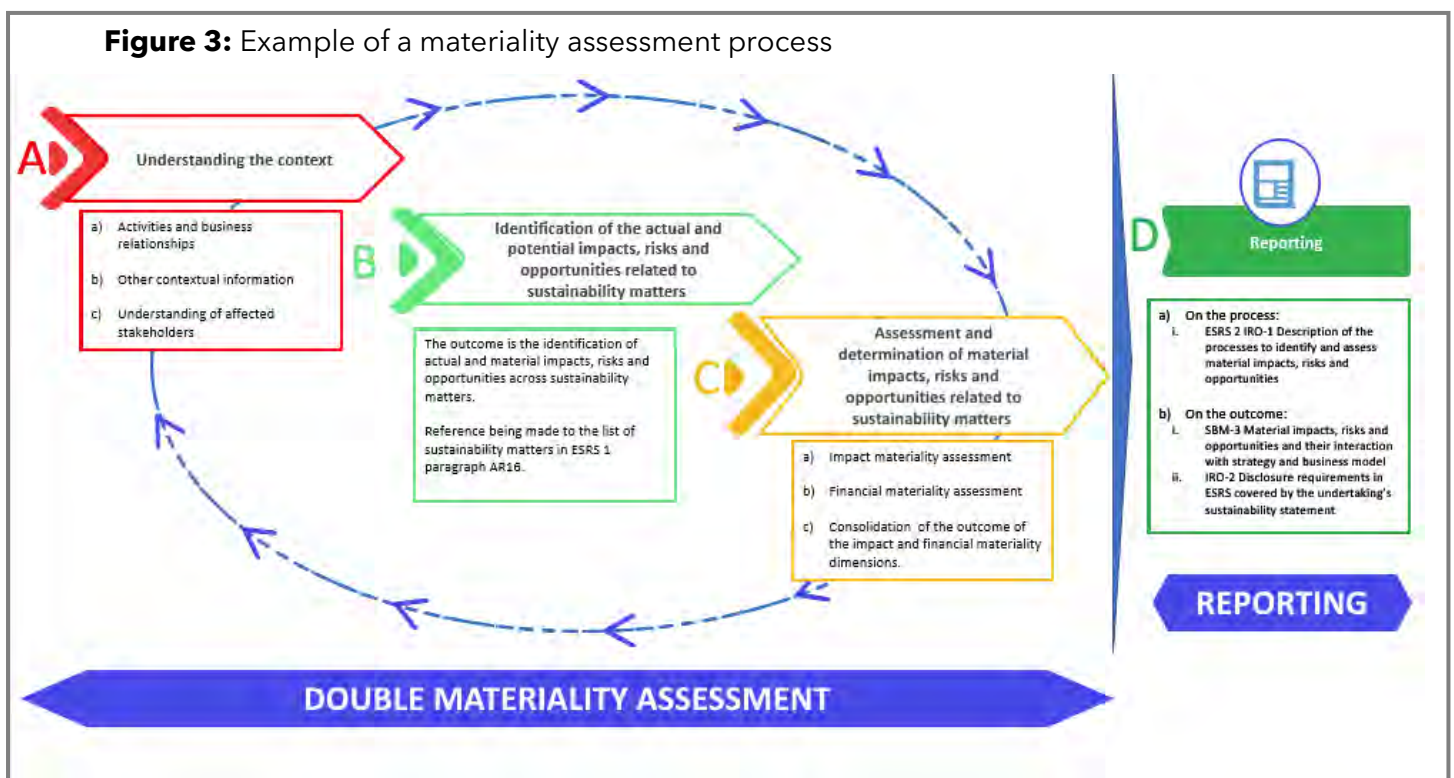
61. The ESRS do not mandate how the materiality assessment process shall be designed or conducted by an undertaking. This is because no one process would suit all types of economic activity, organisational structure, location of operations or upstream and downstream value chains of all undertakings applying the ESRS.
62. Therefore, an undertaking shall design a process that is fit for purpose, based on its specific facts and circumstances, including consideration of the depth of the assessment, as per the requirements of ESRS 1 Chapter 3, and the DRs regarding the materiality assessment and its outcome (see ESRS 2 IRO-1, IRO-2 and SBM-3). In any case, an undertaking shall consider the full scope of environmental, social and governance matters as listed in ESRS 1 paragraph AR16 as well as any other matter that is material from an entity-specific perspective.



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

64. As an illustration, a materiality assessment aligned with the ESRS could follow the process below, including four possible steps:

- Step A: Understanding the context;
- Step B: Identification of the actual and potential IRO related to sustainability matters;
- Step C: Assessment and determination of the material IROs and related to sustainability matters;
- Step D: Reporting.



65. Chapter 5.3 FAQs on the materiality assessment process provides further guidance with specific FAQs on the process.



3.1 Step A: Understanding the context

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

Activities and business relationships

67. Activities and business relationships related to ESRS 2 SBM-1 are approached as follows:

- (a) the analysis of the undertaking's business plan, strategy, financial statements and, when applicable, other information provided to investors;
- (b) the undertaking's activities, products/services and the geographic locations of these activities; and
- (c) the mapping of the undertaking's business relationships and upstream and/or downstream value chain, including type and nature of business relationships.

Other contextual information

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

- (a) the analysis of the undertaking's relevant legal and regulatory landscape; and
- (b) the analysis of published documentation such as media reports, analysis of peers, existing sector-specific benchmarks, other publications on general sustainability trends and scientific articles.

Understanding of affected stakeholders

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

- (a) an analysis of the existing stakeholder engagement initiatives (such as by the communication, investor relations, business management, sales and procurement teams); and
- (b) a mapping of affected stakeholders across the undertaking's activities and business relationships. Separate groups of affected stakeholders may be identified per activity, product or service and are to be prioritised for a particular sustainability matter (this mapping may be reviewed after Step B as necessary).

70. [Chapter 5.4 FAQs on stakeholder engagement](#) provides further guidance on the role of stakeholders.

3.2 Step B: Identification of the actual and potential IROs related to sustainability matters

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



72. The undertaking should use the list of the sustainability matters in ESRS 1 paragraph AR16 to support this process and to ensure completeness. It is equally important for the undertaking to consider entity-specific sustainability matters not covered in that list, if any. Currently, until the sector standards are issued, sector sustainability matters shall be identified and assessed as entity-specific matters. The available best practices and/or available frameworks and/or other reporting standards, such as the IFRS industry-based guidance and GRI Sector Standards (ESRS 1 paragraph 131 b), are possible sources for identification of entity-specific matters.
73. *[Draft] EFRAG IG 3 - List of ESRS Datapoints* released by EFRAG is not a checklist to identify material matters or IROs, as it serves a different purpose. However, it can provide a useful inventory of the coverage of the sustainability matters by the ESRS topical standards at a more granular level (for example, metrics) than ESRS 1 para AR16.
74. For each identified IRO, the undertaking shall disclose whether it relates to own operations, upstream or downstream value chain and the relevant time horizon per ESRS 1 Chapter 6.4 *Definition of short-, medium- and long-term for reporting purposes*.

Approaches

75. Identification of the potential matters may start from screening the list of matters summarised in ESRS 1 paragraph AR 16 and then be completed by additional entity-specific matters. These may follow from either internal processes, (e.g., due diligence, risk management or grievance mechanisms) or external sources such as those described in paragraph 69 above and stakeholder engagement.
76. The undertaking may also develop a 'long' list of impacts, risks and opportunities relevant to its business model and upstream/downstream value chain and aggregate them following the structure of ESRS 1 paragraph AR 16. The approach detailed in paragraph 75 above could be effective for undertakings new to preparing the sustainability statement. Alternatively, an undertaking could start from the matters as informed by existing processes (e.g., GRI reporting or internal processes such as due diligence and risk management). Then the undertaking could compare the matters identified with the list in ESRS 1 AR16 for completeness. The two approaches may be combined.
77. Regardless of the approach chosen to identify material sustainability matters, the purpose is to connect them to the corresponding IROs.
78. The undertaking may aggregate or disaggregate the IROs at the most appropriate level according to its facts and circumstances. It should relate the names it uses (or used before ESRS implementation) for sustainability matters, when these differ from the list in ESRS 1 AR16.
79. [Chapter 5.5 FAQs on aggregation/disaggregation](#) provides further guidance on aggregation/disaggregation.

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

80. In this step, the undertaking applies criteria for assessing impact and financial materiality, in order to determine the material actual and potential impacts, and material risks and opportunities. This then forms the basis for determining material information, based on the ESRS topical disclosure requirements.
81. In ESRS 1 and ESRS 2, emphasis is being placed on setting appropriate qualitative or quantitative thresholds to assess materiality of IROs and related disclosures. In particular,



ESRS 2 paragraphs 53 and 59 require disclosing how these thresholds have been set or applied.

3.3.1 Impact materiality assessment

82. ESRS 1 chapter 3.4 requires that undertakings apply objective criteria using appropriate quantitative and/or qualitative thresholds to assess the materiality of current and potential impacts. This is based on severity and, for potential impacts, also likelihood (see [chapter 3.6 Deep dive on impact materiality - Setting thresholds](#)).
83. Therefore, the undertaking shall apply the criteria for severity to the list of impacts defined in step B above. The criteria are scale, scope and irremediable character of the impact, for actual negative impacts. For potential negative impacts, the undertaking estimates also the likelihood of the impact occurring and maps it to the relevant time horizon. For actual positive impacts, the criteria are scale and scope and for future positive impacts, the undertaking shall also estimate the likelihood of occurrence.
84. Depending on the kind of impact, it may not always be necessary to assess in depth each of the criteria of severity based on the undertaking's specific facts and circumstances, to determine whether the impact is material or not. For example, when there is an established scientific consensus about the severity of a particular kind of global and localised environmental impact, the undertaking can conclude that it is, indeed, material without an in-depth analysis of scale, scope and irremediability. Therefore, the undertaking shall exercise judgement, informed by the available evidence, on the appropriate level of the assessment of the severity criteria.
85. The purpose of engagement with key stakeholders (including workers and their representatives) is to help the undertaking understand how they may be impacted. And, therefore, it may help the undertaking assess the severity and likelihood of impacts⁴. Internal engagement with the undertaking's business functions and employees, and external engagement with users of sustainability reporting and other experts may also help to assess, validate and ensure completeness of the outcome of the materiality assessment (see ESRS 1 paragraph AR8).
86. [Chapter 3.5 Role and approach to stakeholders in the materiality assessment process](#) and [chapter 3.6 Deep dive on impact materiality - Setting thresholds](#) provide detailed guidance on the application of impact materiality criteria and thresholds. [Chapter 5.1 FAQs on impact materiality](#) provides further guidance on impact materiality. See also [chapter 4.3 Leveraging international instruments of due diligence](#).

3.3.2 Financial materiality assessment

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

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

opportunities from step B above and apply a set of objective thresholds for likelihood and magnitude and also consider nature for the effects of the identified risks and opportunities.

89. As most impacts give rise to financial risks and opportunities, the undertaking generally will assess whether material financial effects derive from the impacts identified (including the outcome of step B).
90. When applicable, the undertaking may compare the material risks and opportunities per the list prepared in step B to the ones used in its risk management process (for example, ERM⁵ processes). However, this is only when the latter also covers sustainability risks. In such a case, the likelihood of the risks and opportunities or their related financial effects could be estimated accordingly.
91. It may be appropriate to engage with the undertaking's business functions to assess, validate and ensure completeness of the list of material risks and opportunities as well as with investors of the undertaking and other financial counterparties (e.g., banks).
92. Once a matter has been assessed to be material from a financial perspective, the undertaking determines the information to be reported based on its materiality (see [chapter 2.3 Criteria to determine the materiality of information](#)). In both cases, information is considered material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general-purpose financial reports take on the basis of the undertaking's sustainability statement, relating to providing resources to the undertaking.
93. While the terms 'risks and opportunities' are combined in the ESRS, depending on the specific circumstances, there are matters that trigger the exposure to risks only, others that trigger the exposure to opportunities only and others that trigger the exposure to both.
94. [Chapter 5.2 FAQs on financial materiality](#) provides further guidance on financial materiality.

3.3.3 Consolidating impact and financial materiality outcomes including their interaction

95. This step consolidates the results of the previous steps and obtain the list of material IROs which forms the basis for the preparation of the sustainability statement. Analysis performed at material topic/sub-topic or sub-sub-topic level is to be converted to IROs if this has not been done yet.
96. Once the undertaking has assessed individual IROs based on appropriate thresholds and methodologies, it may aggregate the resulting IROs for reporting purposes (refer to ESRS 1 para 56). Those in charge of this activity may also validate the aggregated double materiality results with the management to assess and validate the completeness of the list of material IROs.

3.4 Step D: Reporting

97. Following the materiality assessment process, the undertaking shall report the assessment process and its outcome based on:
 - (a) ESRS 2 IRO-1 Description of the processes to identify and assess material impacts, risks and opportunities;

⁵ Enterprise Risk Management, see https://docs.wbcsd.org/2018/10/COSO_WBCSD_ESGERM_Guidance.pdf

- (b) ESRS 2 SBM-3 Material impacts, risks and opportunities and their interaction with strategy and business model; and
- (c) ESRS 2 IRO-2 *Disclosure requirements in ESRS covered by the undertaking's sustainability statement*. The undertaking shall also disclose how it has determined the material information to be disclosed, including thresholds and criteria used to assess such information (ESRS 2 paragraph 59).

98. [Chapter 5.6 FAQs on reporting](#) provides further guidance on reporting.

3.5 Role and approach to stakeholders in the materiality assessment process

99. Stakeholders are classified into the following two groups: affected stakeholders and users of the sustainability statement⁶ (ESRS 1 paragraph 22). Some, but not all, stakeholders may belong to both groups (ESRS 1 paragraph 23).
100. ESRS 2 requires transparency on the undertaking's consultation with affected stakeholders (IRO-1, paragraph 53 (b) iii). Even though the ESRS do not mandate behaviour, the undertaking is required to disclose whether and how the materiality assessment process identifies and assesses its impacts, including consultation with affected stakeholders to understand how they may be impacted.
101. The outcome of the undertaking's ongoing due diligence processes that are in place are generally useful to inform the materiality assessment. However, the ESRS do not impose due diligence processes only for the purpose of reporting.
102. In particular, the ESRS clarify that the materiality assessment process is informed by the due diligence process per the international due diligence instruments. These are the OECD Guidelines for Multinational Enterprises (MNE Guidelines) and the UN Guiding Principles on Business and Human Rights (UNGPs). The engagement with affected stakeholders is central to the undertaking's due diligence and impact assessment (ESRS 1 paragraph 24). The undertaking may engage with affected stakeholders or experts to provide inputs or feedback on the conclusions of the materiality assessment (ESRS 1 AR 8). Such engagement may provide evidence or insights into actual or potential impacts on people and environment connected with the undertaking. Social dialogue with workers' representatives at undertaking level is regulated at both European Union and national levels. Under the Accounting Directive (as amended by the CSRD), Member States have to require undertakings to inform the workers' representatives about sustainability reporting and to discuss with them the relevant information and the means of obtaining and verifying it.
103. Engaging, for example consulting, with affected stakeholders and incorporating their views into the materiality assessment helps to substantiate their perspectives when determining the relevance of sustainability matters to them. For example, this includes engaging with the undertaking's employees and/or their representatives on health and

⁶ Stakeholders are those who can affect or be affected by the undertaking. There are two main groups of stakeholders:

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



safety matters. Such engagement also includes feedback received from stakeholders from ongoing processes of engagement as part of the undertaking's business practices.

104. When performing the materiality assessment, an undertaking may leverage on its ongoing dialogue with affected stakeholders or may reach out to stakeholders specifically in the context of its reporting process.
105. Dialogue with affected stakeholders may assist during various steps of the materiality assessment. However, engagement with affected stakeholders in each step of the materiality assessment separately is not necessary, as undertakings may already have ongoing engagement with them to use. As mentioned in paragraph 69 of Step A, the mapping of affected stakeholders and, where possible, prioritising them could be the first step. As part of step B, the undertaking may engage with them or build on past or ongoing engagement to map the impacts that they experience. Finally, in step C, the undertaking may involve affected stakeholders in the assessment of the severity and likelihood of negative impacts that are relevant for them, as well as, for example in case of particularly severe impacts, in validating or providing feedback on impacts that have been assessed by the undertaking as material.
106. In situations when consultation with stakeholders is not possible (for instance, because such engagement would put them at risk), the undertaking may consider appropriate alternatives. This may include consulting credible independent experts (ESRS S3 *Affected communities*), a Non-Governmental Organisation (NGO) representing this affected community or, for environmental matters, scientific articles and reports.
107. A source to consult for impact materiality is the scientific research; in particular, for environmental matters, where credible scientific reports and other sources may be key to objectively assess the severity and/or likelihood of impacts.
108. Separately from the above-described activities, engagement with users may also corroborate the evidence that support financial materiality of sustainability matters and help companies assess financial materiality. The conclusions of the ESRS financial materiality assessment should be based on supportable evidence, which include views and interests of users. This is aligned with current practice for the financial reporting materiality processes, where notes to the financial statements and presentations to investors are adjusted regularly to reflect emerging issues and other matters of interest to investors. To this extent, the undertaking could leverage existing mechanisms of dialogue with shareholders, other investors, and lenders, to support its financial materiality assessment process.
109. In its approach to dialogue with users of sustainability information, the undertaking shall consider stakeholders other than investors who may also be interested in general-purpose sustainability-related financial information, as such information may be useful to assess how the undertaking manages its material impacts.
110. [Chapter 5.4 FAQs on stakeholder engagement](#) provides further guidance.

3.6 Deep dive on impact materiality: Setting thresholds

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



112. ESRS 1 chapter 3.4 clarifies that, for actual and negative impacts, materiality is based on the severity of the impact; while for positive impacts, materiality is based on the scale and scope. For potential impacts, materiality also includes consideration of their likelihood.
113. The severity of an actual or potential negative impact is assessed from the perspective of the affected people or the environment and it is determined by the following characteristics that inform the basis for determining the thresholds:
- (a) **Scale**: how grave the impact is (i.e., extent of infringement of access to basic life necessities or freedoms (e.g., education, livelihood etc.);
 - (b) **Scope**: how widespread the impact is (i.e., number of individuals affected or the extent of the environmental damage); and
 - (c) **Irremediable** character: the extent to which the impact can be remediated (e.g., through compensation or restitution; whether the people affected can be restored to their exercise of the right in question). The underlying question is: are there any limits on the ability to restore the environment or those affected to a situation at least the same as, or equivalent to, their situation before the negative impact?
114. As discussed above, 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 negative impacts is driven by an analysis of severity and/or risk prioritisation, which may inform the assessment of impact materiality.
115. When setting up thresholds, priority should be given to any supportable evidence that provides as much objectivity as possible to the materiality conclusion. However, reasonable quantification of the potential impacts may not always be possible to support the materiality assessment.
116. Any of the three characteristics of severity can make an impact severe, but often the characteristics are interdependent. Irremediable character could impact the severity by increasing its gravity or scale. In turn, it is often the case that the greater the scale or the scope of an impact, the less it is remediable.

3.6.1 Actual impacts

117. In the application of the concepts described above, as an illustration, an undertaking could map its actual impacts to the three characteristics of severity in a column format (figure 4) and could follow the criteria below, aligned with para 116 above.



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

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

| Negative impact | Severity assessment | | | Is the impact assessed as material? |
|-----------------|---------------------|--------|-----------------|-------------------------------------|
| | Scale | Scope | Irremediability | |
| Impact 1 | Low | Medium | Low | No |
| Impact 2 | Low | High | Low | Yes |
| Impact 3 | Medium | Medium | Low | Yes |
| ... | Low | Low | Low | No |
| Impact N | High | Low | Medium | Yes |



3.6.2 Potential impacts

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

119. 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.

120. 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).

121. A similar approach to the actual impacts could be applied whereby the threshold for reporting material impacts is defined as the red area in the illustrative graph below. In this illustrative example, the undertaking has assessed that high severity (scale 5), and low likelihood (scale 1) of negative impacts are material for environmental matters; such decision is based on the judgement of the undertaking.

Example

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

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

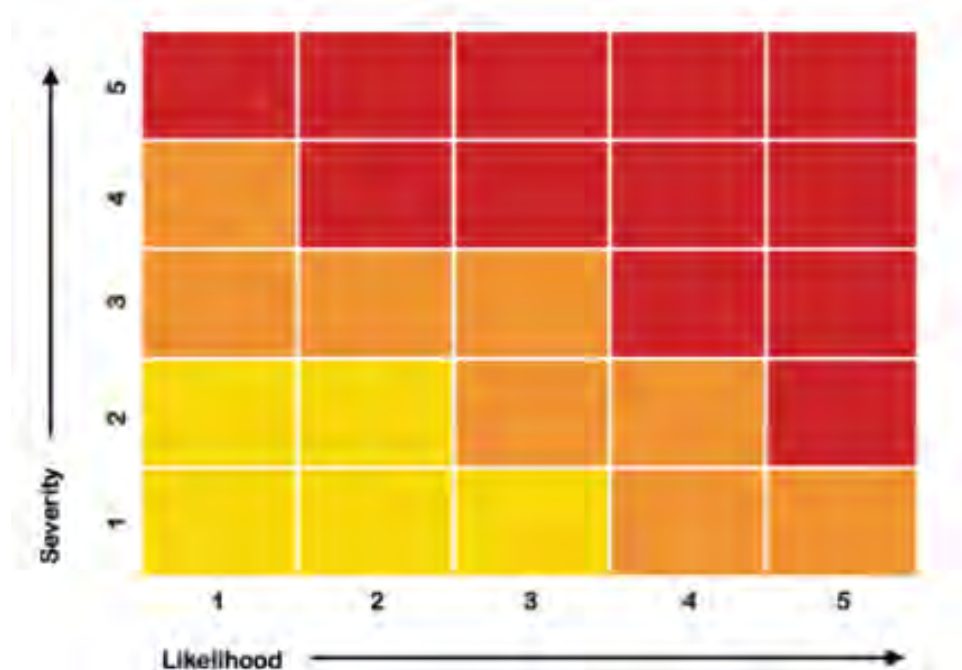
Therefore, the fact that an undertaking is acquired, and forms part of a group does not change the severity categorisation of scale or irremediable character.



Impacts with very low probability may or may not be material depending on the severity if they occur. In the illustration provided in Figure 5, it is assumed that an impact with the lowest level of likelihood could be assessed to pertain to the highest level of materiality, as it would have catastrophic environmental consequences related to environmental hazards.

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

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



3.7 Deep dive on financial materiality: Setting thresholds

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

123. 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 source of inspiration. However, the undertaking shall consider that the time horizon for financial materiality assessment in sustainability reporting is longer than the typical time horizon factored in financial statements and management commentary. This may result in the need to consider the cumulative effect of a sustainability matter on



revenues, costs, etc. over a lengthy period. Similarly, a threshold for likelihood needs to consider the cumulative probability over a period of time, to cover the long-term horizon as well.

124. 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 yet meet) the criteria for accounting recognition (ESRS 1 paragraph AR 14 and AR 15).
125. 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). In this case, there is a similarity with financial reporting, where materiality is not confined to quantitative aspects, but a transaction may be material due to its nature, i.e., qualitative approach to materiality.
126. With reference to the qualitative approach to materiality, there are circumstances in which, depending on the sector the undertaking is active in, or depending on characteristics of its business model or operations, the undertaking is exposed to reputational risks that are of interest for investors. In this case, while an effect on cash flows cannot be quantified, the reputational risk may influence the availability of finance and/or cost of funding and therefore, may be financially material.
127. When the undertaking has in place mechanisms of dialogue with its shareholders, investors and lenders, it may corroborate the determination of its materiality threshold(s) in the context of financial materiality. This is to report on information that, if omitted, misstated or obscured, could reasonably be expected to influence decisions that those stakeholders make based on its sustainability statement (ESRS 1 paragraph 48).
128. As many sustainability matters that generate material impacts are also sources of material risks and opportunities, the undertaking shall carefully consider the linkages in its financial materiality assessment (refer to [chapter 3 Step B and C](#)).

4. How to leverage other sources⁷?

4.1 Leveraging the GRI standards

129. An assessment performed under GRI is focussed on impact materiality but not the financial materiality dimension, as GRI is not based on double materiality like the ESRS (see [chapter 2.1 Implementing the concept of double materiality](#)). However, the impact dimension is the same under GRI Universal Standards and the ESRS, even if the scope of environmental, social and governance matters under GRI may not exactly be the same with that of the ESRS. Therefore, an assessment performed under GRI Universal Standards constitutes a good basis for the assessment of impacts under the ESRS. The financial materiality dimension is to be added when moving from the GRI Universal Standards reporting framework to that of the ESRS.
130. Several synergies exist for undertakings that are currently reporting under the GRI Universal Standards 2021 framework in terms of:

⁷ The content of this chapter reflects the views of EFRAG and has not been validated by GRI nor by ISSB.



- (a) impact materiality assessment process: ESRS 1 Chapter 3.3, ESRS 2 IRO-1 and IRO-2 are aligned in substance with GRI Universal Standards and the GRI materiality assessment can be the starting point for the ESRS double materiality assessment, with appropriate integration of financial materiality;
- (b) the universe of potential impacts identified using the GRI Universal Standards are compatible in principle with the list of matters in ESRS 1 paragraph AR 16 (and therefore also with the ESRS architecture). In addition, a GRI materiality assessment can inform the process of identifying the entity-specific impacts; and
- (c) role of due diligence and stakeholder engagement is central to both frameworks in informing the impact materiality assessment.

4.2 Leveraging the ISSB standards

131. In EFRAG's intentions and expectations, the criteria for financial materiality and materiality of information in the ESRS and the corresponding materiality approach in IFRS S1 are aligned. The following paragraphs illustrate the alignment.
132. The financial materiality assessment in ESRS 1 corresponds to the identification of material information needed by primary users of general-purpose financial reports when making decisions relating to the provision of resources to the undertaking (ESRS 1 paragraph 48, aligned with IFRS S1 paragraph 1). The definition of financial materiality is aligned between the two standards⁸.
133. Because the criteria financial materiality in the two frameworks are aligned, an undertaking that applies the ESRS is expected to comply with the identification of the risks and opportunities under IFRS using the outcome of its ESRS assessment of financial materiality. In other words, the same financial materiality assessment process can support the identification of the risks and opportunities for both IFRS and ESRS purposes.
134. The general criterion for assessing the materiality of information and therefore to support the identification of the information to be reported (ESRS 1 paragraph 31) is expected, in most cases, to rely on decision-usefulness (see [chapter 2.3 Criteria to determine the materiality of information](#)); this is also the criterion used in IFRS S1 to identify the information to be reported (as material). While in the ESRS the assessment of what is decision-useful considers both investors and other stakeholders, in IFRS this is limited to the users' needs of investors. However, the financial materiality dimension of the ESRS is focused on investors and, therefore, also aligned with IFRS S1. This is compatible with the general principle of double materiality, as the information dataset that serves the needs of investors (financial materiality) is expected to be the same that fulfils the potential outside-

⁸ For both IFRS S1 and ESRS 1, information is considered material for primary users of general-purpose financial reports if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the undertaking's sustainability statement. In addition, IFRS S1 requires to disclose information about all sustainability-related risks and opportunities that could reasonably be expected to affect the entity's cash flows, its access to finance or cost of capital over the short, medium or long term. Under ESRS 2 SBM-3, the undertaking shall disclose its material impacts, risks and opportunities. Under ESRS 1, "A sustainability matter is material from a financial perspective if it generates risks or opportunities that have a material influence or could reasonably be expected to have a material influence, on the undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term" (ESRS 1 paragraph 49).



in⁹ information needs of other users (trade unions, academics, etc). The following examples illustrate this concept:

- (a) affected communities may be interested in whether the provisions set aside to rehabilitate polluted production sites are sufficient to cover the necessary rehabilitation activities; and
- (b) current and prospective employees may want to learn about anticipated financial effects that could impact their prospects within the organisation (e.g., pensions or training).

135. Finally, IFRS S1 (paragraph 55) requires a reporting entity to refer to and consider the applicability of the disclosure topics in the SASB Standards. Similarly, following ESRS 1 AR 4 an undertaking shall consider IFRS standards¹⁰ as source of possible entity specific disclosure. In addition, ESRS 1 transitional provisions (paragraph 131 (b)) identify IFRS sector-standards as a source of disclosure that an undertaking may use in the definition of its entity-specific disclosures in the absence of ESRS sector-specific standards. While for ESRS preparers the use of SASB standards is optional (as this is a possible source of disclosure, but not the only one), the provision of entity-specific disclosure including sector metrics is a requirement (see ESRS 1 paragraph 11, AR 1 to AR 5).

4.3 Leveraging international instruments of due diligence

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

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

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

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

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

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

5. Frequently asked questions (FAQ)

5.1 FAQs on impact materiality

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

140. Consider Impact materiality is based on its impact on people or the environment, which are in turn affected stakeholders for the undertaking.
141. The scope of impact materiality includes impacts on people and/or the environment 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. It is assessed by reference to the severity of such impacts on the people and/or environment for actual or potential impacts. To assess impacts, stakeholder engagement is critical as described in [FAQ 16 Do ESRS mandate to actively engage with stakeholders?](#)
142. In contrast, financial materiality focusses on the effects of sustainability matters on the undertaking's cash flows, financial performance and position, access to finance or cost of capital, in the short-, medium- or long term, as such effects are material to the undertaking's investors.
143. When material impacts are also associated with material risks and opportunities, they are also 'material for the undertaking'. However, impact materiality is assessed based on severity to 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?

144. As explained above, impact materiality covers 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 several ways as described below according to the international due diligence instruments.
145. The undertaking may be single-handedly responsible for the impacts to people or the environment, as the **impacts are directly caused** by its operations, products or services. For example:
- (a) exposure of the undertaking's own workers to hazardous working conditions without adequate safety equipment;
 - (b) being the sole source of pollution in a community's drinking water supply due to chemical effluents from its production processes;
 - (c) for a positive impact, an energy producer lowering the cost of renewable energy, allowing more customers to switch to renewable energy, and so contributing to mitigating climate change.
146. **Impacts to which the undertaking has contributed to** are those not caused directly and solely by the undertaking's operations, products, or services, but in conjunction with a third party. Therefore, the undertaking's action or omission do not single-handedly cause the impact but do so with others' actions or omissions. For example, several factories locally release harmful emissions which are individually below harmful limits. However,



together they affect the quality of the air in the local community, leading to a negative impact on the people and the environment.

147. Another example is when the undertaking facilitates or incentivises another party to cause or contribute to the impact. For example, changing requirements to suppliers repeatedly without adjusting production deadlines and prices, thus pushing suppliers to breach labour standards to deliver.
148. **Impacts directly linked to the undertaking's operations, products, and services caused by a business relationship.** In this case the entity causing or contributing to the impact is linked to the undertaking through a business relationship. Business relationships are not limited to contractual relationships and partners with whom the undertaking directly interacts, they include actors across the entire upstream/downstream value chain, including beyond first tier. For example, a supplier subcontracting embroidery on clothing to child labourers, contrary to the contractual obligations.
149. The type of involvement (i.e. directly caused, contributed to or directly linked) is important given that it could lead to a different assessment or categorisation of the negative impact.

FAQ 1: What are material IROs in the value chain?

150. See [VCIG FAQ 3: How should the materiality assessment process be organised to properly capture material IROs that arise in the value chain?](#)

FAQ 2: Can positive impacts be netted against negative impacts?

151. No. Impacts are to be assessed on a gross basis. This means that positive impacts on the environment and people cannot be netted against negative impacts.
152. This is based on the following non -exhaustive list of principles:
- (a) different nature of impacts: an undertaking shall not net positive impacts with negative impacts of a different nature (in the reporting year or in future years). This contradicts ESRS 1 paragraph 56: "... *The undertaking shall not aggregate material items that differ in nature*", as well as the qualitative characteristics of quality (QC 8 Appendix B of ESRS 1);
 - (b) timing of impacts: an undertaking shall not net actual negative/positive impacts in the reporting year with positive/negative impacts of the same nature in future years; and
 - (c) own operations or upstream/downstream value chain): an undertaking shall not net impacts in own operations with impacts in the upstream/downstream value chain.
153. Netting should not be confused with compensation/offsetting. While netting negative with positive impacts in own operations and the upstream/downstream value chain is to be avoided, ESRS E1 *Climate change* and ESRS E4 *Biodiversity and ecosystems* include specific requirements on how to report on carbon credits and biodiversity credits.

5.2 FAQs on financial materiality

FAQ 3: Is the material information for financial statements the same as for the sustainability statement?

154. No, it is not the same. However, the objective remains the same.
155. The financial materiality assessment of information depends on 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. The scope of financial materiality for the sustainability statement is an expansion of the scope of materiality used to determine the information to be included in the undertaking's financial statements (ESRS 1 paragraph 47). Whilst the concept of materiality does not differ between ESRS and financial reporting standards, the information that is likely to be material following the two sets of standards does. The principles applied for the preparation of the financial statements (under IFRS or local Generally Accepted Accounting Principles (GAAPs)), as illustrated by the financial reporting conceptual framework for IFRS, establish a clear delineation of what should be accounted for, on the basis of criteria for recognition of assets and liabilities, and income and expenses. As a result, when defining the thresholds for financial materiality used in the preparation of the sustainability statement, inspiration could be drawn from criteria and thresholds used in the preparation of the financial statements.

156. The differences between information that is likely to be financially materiality for the financial statements and the information that is likely to be financially materiality for the 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. These could be reasonably expected to result in financial effects for the undertaking. Therefore, it is more likely that risks and opportunities that are not yet material for financial statements and management commentary, could be material for the sustainability statement, where there are different underlying principles to provide information on assets and liabilities (or on resources/opportunities and risks before they meet the accounting definition of assets and liabilities);
- (b) the information on the group is expanded in the sustainability statement to include information about material risks and opportunities arising from its business relationships, i.e., in the upstream/downstream value chain. Therefore, it is more likely that information about risks and opportunities arising from the undertaking's upstream/downstream value chain may be material for the sustainability statement but not included in the financial statement; and
- (c) future events may trigger anticipated sustainability-related risks and opportunities while financial statements typically account for risks based upon past events. Therefore, it is more likely that forward -looking information (such as anticipated financial effects) become material in the sustainability statement; and
- (d) time horizons may be longer in sustainability reporting as it is not constrained by the financial planning horizon or by the historical cost convention.

FAQ 4: Is financial materiality for sustainability reporting limited to effects presented in financial statements?

157. No. As described in [FAQ 5 Is the material information for financial statements the same as for the sustainability statements?](#) the basis for preparation and time horizons of financial and sustainability reporting differs. The concept of current and anticipated financial effects defined in Annex 2 of the delegated act distinguishes between:

- (a) financial effects that have already crystallised and are recognised in the primary financial statements (i.e., current financial effects); and
- (b) financial effects that do not meet the recognition criteria for inclusion in the financial statements in the reporting period (i.e., anticipated financial effects).



158. Reporting certain financial effects associated with material sustainability matters in sustainability statement goes beyond what is required to be recognised and measured in the primary financial statements and disclosed in the notes to financial statements. In particular, financial effects that arise from risks and opportunities are to be reported irrespective of their accounting treatment, when they have or could reasonably be expected to have a material influence on the undertaking's financial position, financial performance and cash flows, over the short-, medium- and long- term. Sustainability risks or opportunities may derive from past or future events and may have financial effects in relation to:
- (a) assets and liabilities already recognised in financial reporting. Potential adjustments to the carrying amount that are of interest for users of sustainability statement may not meet the accounting criteria for recognition in financial statements at the reporting date albeit these anticipated financial effects are reported in sustainability statement given the relevance to users;
 - (b) assets, liabilities, income and expenses that may only be recognised in financial reporting at a later stage, but are useful to users of sustainability statement; and
 - (c) factors of value creation that do not meet the recognition criteria for the financial statements but contribute to the generation of cash flows and the development of the undertaking. These may include internally generated intangibles such as human capital that could be described in sustainability reporting.

5.3 FAQs on the materiality assessment process

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

159. The CSRD defines the frequency of sustainability reporting under the ESRS as annual given that 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.
160. However, if the undertaking concludes based on appropriate evidence that the outcome of the prior reporting period materiality assessment is still relevant at the reporting date, the preparation of the sustainability statement may use the conclusions previously reached. This may be true if the undertaking assesses that there have been no material changes in its organisational and operational structure of the undertaking and there have been no material changes in the external factors that could generate new or modify existing IROs or that could impact the relevance of a specific disclosure. Examples of changed material facts and circumstances 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 a new material business relationship that is likely to have a severe impact on human rights; and
 - (d) a shift in social conventions, scientific evidence or users' needs that could affect the characteristics of severity (e.g., the level of public scrutiny significantly increases on a matter compared to previous periods or new studies provide evidence of the toxicity of a substance). The analysis performed for the preparation of the



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

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

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

162. No.

163. ESRS 1 paragraph AR 16 states: “Using this list is not a substitute for the process of determining material matters. This list is a tool to support the undertaking’s materiality assessment. The undertaking still needs to consider its own specific circumstances when determining its material matters.” Some undertakings may have a list of material topics from previous impact materiality assessments (for instance, GRI Universal Standards reporting) and will use the list from ESRS 1 paragraph AR 16 as described in step B of the Materiality assessment process, chapter 3.2.

164. The list in ESRS paragraph AR 16 is a good starting point for the identification of sustainability matters, but it should not be used as a checklist substituting a materiality assessment. It is an inventory of the sustainability matters covered in the sector agnostic topical ESRS. Sector-specific¹¹ and entity-specific sustainability matters (see ESRS 1 paragraph 11) should also be considered on top of this list.

165. 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 released (see ESRS 1 paragraph 131 (b)).

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

166. 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 to be factored into the process. ESRS 1 paragraphs 77 to 81 define the standardised terms for time horizon, and it provides an option to select entity-specific horizons for medium- and long- term.

167. In the double materiality analysis, the short-, medium- and long-term time horizon may be considered:

- (a) for a proper **understanding** of the undertaking’s facts and circumstances to

Example 1

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

Example 2

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

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

set an appropriate time horizon based on the context of the undertaking;

- (b) for a proper **identification** of the list of sustainability matters as the undertaking needs to reflect the entire time horizon (short/medium/long) to determine whether the IRO may occur or not; and
- (c) for the **assessment** of material matters the undertaking may consider whether the financial effects linked to a material impact may crystallise in a different time horizon to another impact. Also, materiality thresholds might be affected by the time horizon.

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

168. Where possible, yes, as quantitative measures of IROs are the most objective evidence of their materiality.

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

170. 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 is “material”, additional quantitative information would not add value to the materiality assessment. As the materiality assessment process evolves over time, the undertaking may redefine the balance between qualitative or quantitative information.

Example

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 quantitative information on severity (i.e., scale or scope) as described below to prioritise the impacts. For example:

171. Quantitative information would however be of interest where a topic is on the edge of being material/non-material based on qualitative information and/or where there are diverse views. In that case, quantification could corroborate the conclusion. This could include impact valuation, which has the advantage to make different impacts comparable.

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

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

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

173. No.

174. Even if impact and financial materiality are inter-related and the interconnections between the two dimensions shall be considered (see ESRS 1 chapter 3.3. *Double materiality*), a sustainability matter does not have to be material from both dimensions to be regarded as material for reporting purposes.

175. For example, an undertaking in the extractive industry has assessed health and safety as a material negative impact due to the frequency and severity of work-related accidents in its location. However, the current financial effects are not considered financially material.



Therefore, the impacts and risks and opportunities on this matter are not aggregated and the matter is regarded as material from an impact materiality dimension only.

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

176. The ESRS do not prescribe specific documentation, but it is reasonable to expect a certain level of documentation to be needed for internal purposes. Such documentation could inform those in charge of the governance over the process of sustainability reporting (see ESRS 2 GOV- 5), to prepare the ESRS 2 IRO-1 disclosures and help assurance providers to perform their work.
177. The CSRD modifies the Accounting Directive with respect to the definition of the content of the management report in relation to sustainability information and its digitisation (namely Art 19a and Art 29a) and has introduced mandatory assurance of the sustainability statement (in particular, Art 34). The documentation requirements and level of evidence to support the materiality assessment (i.e., ESRS 2 IRO- 1 and 2 as well as ESRS SBM-3) is outside the remit of the ESRS.

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

178. The ESRS do not prescribe a specific process for the materiality assessment as no one process fits all undertakings, including diversified global undertakings.
179. The parent undertaking (as defined in ESRS 1 chapter 7.6) performs its materiality assessment for the consolidated group for the group's material impacts, risks and opportunities (according to CSRD Art. 29a), irrespective of its group legal structure and of the aggregation used to prepare the disclosures in the consolidated sustainability statement.
180. The parent undertaking may perform its materiality assessment using different approaches, including:
- (a) **a top-down approach**, with an assessment performed at group level while engaging or consulting with the subsidiaries for specific matters; or
 - (b) **a bottom-up approach**, with an assessment performed at subsidiaries level and consolidating the results.
181. An undertaking may face trade-offs in performing its materiality assessment at group level. For example, it may deal with a high severity impact from a small revenue stream and with a medium severity impact from its main revenue stream. Therefore, in defining thresholds (see [step C in chapter 3.3](#)), the parent undertaking of a group operating in different sectors, has to consider an appropriate level of consistency in methodologies and thresholds across the entire group (refer to [chapter 3.7 Deep dive on impact materiality - Setting thresholds](#)).
182. The undertaking can consider IROs or matters commonly associated with its sectors, geographic locations, or with a specific subsidiary (see [Step A in chapter 3.1](#)). Here, the sector standards will help identifying the impacts, risks and opportunities and assessing them.

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

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



184. Both sets of standards will have a consistent architecture. The sector -specific standards will provide a list and description of sustainability matters common to the sector and build on ESRS 1 paragraph AR 16.
185. As a temporary measure before the adoption of the sector-specific standards, the undertaking may use the transitional provision related to entity-specific disclosures (see ESRS 1 chapter 10.1). This allows undertakings to carry forward their previous sustainability disclosures or design additional disclosures using best practice or other frameworks (e.g., IFRS industry-based guidance or GRI) for entity-specific disclosure (per ESRS 1 paragraph 11), as long as this information meets the qualitative characteristics of information laid out in ESRS 1 Appendix B. The transitional provision is applicable for the first three sustainability statements of the undertaking.

5.4 FAQs on stakeholder engagement

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

186. The ESRS require disclosure on the assessment and its outcomes but do not mandate specific behaviour on stakeholder engagement or the due diligence process.
187. However, ESRS 1 paragraph 45 states that the impact materiality assessment is informed by the undertaking's due diligence process. In addition, ESRS 1 paragraph 24 points to affected stakeholders' engagement as central to the materiality assessment. Engagement with affected stakeholders is a tool that supports the undertaking's business processes (for example, due diligence) as well as the management of sustainability matters. The undertaking when preparing its sustainability statement can leverage its engagement with stakeholders per its due diligence process, if applicable.
188. Stakeholder engagement informs the identification and assessment of material impacts. This can help the assessment of severity, likelihood and time horizons and also ensure the completeness of the material impacts identified. Refer to [Chapter 3.5 Role and approach to stakeholders in the materiality assessment](#).

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

189. Engagement with affected stakeholders helps the undertaking to understand which sustainability matters are sources of concern for the respective stakeholders and how they are affected. This information may be useful input to the assessment. For further information, see [chapter 3.5 Role and approach to stakeholders in the materiality assessment](#).
190. 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" per international instruments) rests on the idea that not all stakeholders will be equally affected by the undertaking's activities. Furthermore, the undertaking is to identify the stakeholders' views to be taken into account in connection with a specific activity. It also builds upon the idea that the degree of impact on stakeholders may inform the degree of engagement specifically for prioritisation.
191. The undertaking may consider engaging stakeholders or their representatives to determine whether they are affected or not, if not obvious.



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

FAQ 17: What is the role of silent stakeholders and how to consider them?

193. There may be stakeholders who cannot voice their concerns and in the ESRS nature has been identified as a silent stakeholder (ESRS 1 paragraph AR 7). Nature is an essential part of the sustainability context the undertaking and its value chain operate in. Nature, unlike other stakeholders, cannot voice its concern on its own, verbally or in writing. Data from scientific sources (e.g. scientific studies on the planetary boundaries or scientifically validated data) may give nature a voice, as it may explain the state of nature, such as the health of bird populations, state of water bodies, condition of a forest.

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

195. Examples on considering silent stakeholders could be:

- (a) Identifying the silent stakeholders likely to be impacted by the undertaking's activities, and the actual and associated potential impacts of the undertaking;
- (b) Research to understand the potential or actual impacts on these stakeholders such as review of scientific studies, articles and environmental impact assessments. Such research can be on a global level (e.g., planetary boundaries for biodiversity) or a local level (e.g. via its impact on stressed water bodies or identifying the type of species impacted);
- (c) Using proxies such as organisations that are legitimate representatives or are considered by the undertaking to appropriately represent the silent stakeholder. For nature, the undertaking may consider organisations that assess the current and future state of the ecosystem, water resources or climate; and
- (d) Testing the results of the estimated potential impacts based on experts' consultation, collaborative partnership with NGOs, and other stakeholders.

5.5 FAQs on aggregation / disaggregation

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

196. 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 and it may be different across the various material impacts. For risks and opportunities, it should reflect the magnitude of current financial effects while for anticipated financial effects it should reflect the magnitude and likelihood. The principle is to avoid obscuring the specificity and context necessary to interpret the information and to avoid the aggregation of material items of a different nature. This is set out in ESRS 1 paragraph 54: *"When needed for a proper understanding of its material impacts, risks and opportunities, the undertaking shall disaggregate the reported information:*

- a) by country, when there are significant variations of material impacts, risks and opportunities across countries and when presenting the information at a higher level of



aggregation (for instance, region) would obscure material information about impacts, risks or opportunities; or

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

Examples

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

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

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

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

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

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

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



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

202. As the disaggregation for financial reporting segments is designed for a different purpose and, in general, it is not expected to be the starting point to reflect the material IROs across the components of the undertaking's operations. The appropriate disaggregation unit for IROs in sustainability statement may be a country, site, or significant asset when material impacts, risks and opportunities arise in a specific country, 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 IROs (see ESRS 1 paragraph 54). Refer to [FAQ 18 Does the undertaking use the same criteria when defining the level of disaggregation across all IROs?](#)

Example

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

When performing its sustainability materiality assessment on water, the undertaking determines that the material negative impacts are correlated 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.

203. Therefore, a disaggregation following the segments used for financial reporting may not be granular enough or relevant for sustainability reporting¹².

5.6 FAQs on reporting

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

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

205. As explained in [FAQ 12 Should the materiality assessment be documented/evidenced?](#) the ESRS do not prescribe specific documentation, however it is reasonable to expect that a certain level of documentation will be produced. This could be used for internal purposes and for the assurance providers of the undertaking's sustainability statement.

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

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

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

207. The determination of information to be reported for metrics is informed by the assessment of the materiality of information (refer to [chapter 2.3 Criteria to determine the materiality of information](#)). Hence, if a matter is material due to its impacts and there are no material risks and opportunities arising from the same matter, information disclosed on metrics may be limited to metrics that are relevant under the impact materiality perspective and the datapoints related to the risks and opportunities or financial effects are omitted¹³ (ESRS 1 paragraphs 31 and 34).

208. When a matter is assessed to be material from a financial (or impact) perspective only the information about policies, actions and targets shall cover all the datapoints in the minimum disclosure requirements¹⁴ and the topical standards (ESRS 1 paragraph 33). The level of detail of such information will reflect the general approach to information materiality (ESRS 1 paragraph 31), but the undertaking does not differentiate between information relevant from financial perspective and information relevant from impact perspective. The undertaking will describe the content of policies, actions and targets in place.

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

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

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

¹³ A datapoint of a Disclosure Requirement in metrics may be omitted when the corresponding information is assessed to be not material provided that the omitted information is not needed to meet the objective of the Disclosure Requirement (ESRS 1 paragraph 34).

¹⁴ See ESRS 2 Chapter 4.2 *Minimum Disclosure Requirements on policies and actions* and Minimum Disclosure Requirements on targets in chapter 5 *Metrics and targets*.



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

212. However, ESRS 1 paragraph 57 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.” Therefore, undertakings can disaggregate the metric information further than providing it at group level only when this is required by a topical standard or deemed relevant at entity-specific level.

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

214. In addition, the ESRS stipulates for the level of disaggregation that “when needed for a proper understanding of its material IROs, the undertaking shall disaggregate the reported information ...” (ESRS 1 paragraph 54).

FAQ 23: When an undertaking has actions in place to avoid, minimise, restore or compensate environmental impacts, shall it report on the impacts before those actions?

215. As a general principle, environmental impacts are considered gross (i.e. before any mitigating actions) in the materiality assessment. This is linked to the objective of providing information on the management of impacts by the undertaking over time. Therefore, the users of the sustainability statement will receive information on the actual impacts where no distinction is made between gross and net. And, for potential impacts the following applies:

- (a) information on the gross impact (i.e., before taking into account the mitigation hierarchy);
- (b) the management of such impacts (i.e., policies, actions and targets); and

Example

Assume a Group is active in sector A and B, with two subsidiaries, A and B respectively. Group has a material IRO in relation to water consumption. However, the IRO is only material for sector A, i.e., subsidiary A. ESRS E3-4 requires that:

- a. total water consumption in m³ is disclosed for own operations, so for the entire Group (ESRS E3 paragraph 28 (a), also for paragraph 28 (c) total and paragraph 28 (d)); and
- b. total water consumption in areas at water risk (ESRS E3 paragraph 28 (b)) would depend on the areas at water risks only relate to sector A or subsidiary A.

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



- (c) understanding the net impact (i.e., after the application of the mitigation hierarchy).
216. This requires differentiation between actual impacts, i.e., those that have happened or are ongoing in the reporting period, and potential impacts, i.e., those that have a likelihood of occurrence in the short-, medium- or long-term future.

Actual impacts

217. The undertaking is expected to assess its actual impacts that have taken place in the current or previous reporting period(s). The severity of the impact, assessed for the current reporting period, will depend on successful mitigation. This is further illustrated as follows:
- (a) For an accident occurred in the current year, such as an oil spill or the failure of an emission treatment facility and subsequent pollution-related impacts, the undertaking is expected to consider these events in its materiality assessment, when identifying actual impacts. Any remediation or rehabilitation activities put in place after the event but in the same period is not taken into account in the materiality assessment. On the contrary, mitigation activities, such as pollution containment or immediate stop of operations that were put in place before the incident are considered when assessing the severity of the actual impact; and
 - (b) For severe negative impacts in the past, these are expected to be considered in the materiality assessment and assessed whether still material in the current reporting period. In this example of the oil spill, aquatic and coastal ecosystems may be materially negatively affected by oil pollution for many years and remain in the materiality assessment for a number of years.

Potential impacts

218. The undertaking is expected to assess its potential impacts and disclose those that are material. The materiality assessment of potential impacts can also consider the effect of technical or other management measures for avoiding or mitigating impacts in the future. However, in order to consider the effect of such measures in the materiality assessment, the assumptions related to the adoption of the measures have to be (i) technically feasible; (ii) economically viable and (iii) accurately described in the report (see ESRS 2 - Annex B: Qualitative characteristics of information). For this to be the case, there should be managerial decisions already taken at the appropriate level of responsibility (e.g. individual or body responsible for authorising the expense for a certain monetary amount) and the effective implementation of the mitigation activities should not depend on third parties' decisions. As an example, if a public authority has to authorise a certain project, the corresponding mitigation activity can be considered only after the authorisation. For example:
- (a) If a chemical producer plans to introduce a new production process using a hazardous substance without any available wastewater treatment technique, it cannot assume in its materiality assessment that such a technique will be available in the future and neglect the potential impact. However, if a treatment technique is available and the undertaking plans to install it, it may disclose this as part of its management of the material impact but cannot be taken into account in the materiality assessment. If the development of the treatment technique is subject to significant uncertainties, the undertaking may explain the hazards related to the use of the substance and the prospects for the treatment technique to be available in the future; and
 - (b) In the case of an ocean oil spill affecting an ecological sensitive area or a failure of an emission treatment facility, the undertaking does not consider its emergency



response protocols when assessing the severity and likelihood of potential impacts but shall describe its mitigation actions for material potential impacts.

219. Examples of avoidance, minimisation, restoration, and compensation are included below:

- (a) **Avoidance:** A mining undertaking plans to develop a new mine in a biodiversity sensitive area. Through careful site selection and project planning, it identifies an alternative location that is less ecologically sensitive. By choosing this less sensitive site, the undertaking avoids disrupting critical habitats and species.
- (b) **Minimisation:** The construction of a new highway will impact a nearby river and its ecosystem. The environmental impact assessment has identified a series of measures that if implemented, will minimize the impact of the highway on the river. These include measures like erosion control, sedimentation ponds, and careful construction scheduling to reduce water pollution during construction. These measures seek to limit the extent and severity of impacts on the river ecosystem.
- (c) **Remediation or Restoration:** An oil spill occurs in a coastal area, harming marine life and the shoreline. In response, the responsible undertaking starts efforts to remediate the damage using oil-absorbing materials, deploying booms to contain the spill, and cleaning up the shoreline to restore it.
- (d) **Compensation:** A real estate developer plans to urbanize a parcel of land that includes a wetland. Despite efforts to avoid and minimise impacts, impacts to the wetland are unavoidable. To compensate for this impact, the developer agrees to create a new wetland nearby (of equal or greater ecological value). This created wetland compensates for the loss of the original wetland and provides additional positive environmental impacts.

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

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

221. Yes. The materiality assessment is performed by the undertaking to identify the material IROs to be reported.

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

Example

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



5.7 FAQs on Art. 8 EU Taxonomy

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

223. The EU Taxonomy Regulation and its Delegated Acts define criteria for a number of economic activities (eligible activities) that need to be fulfilled in order to substantially contribute to one of six environmental objectives. In addition, these activities must do no significant harm (DNSH) to the other environmental objectives and fulfil minimum social safeguards to be considered taxonomy aligned. The environmental objectives of the Taxonomy Regulation are fully reflected in the environmental topics covered by the ESRS.
224. If an undertaking engages in activities that are eligible for the EU Taxonomy, this indicates that it impacts the environmental objective for which the Taxonomy defines substantial contribution (SC). The following information can be an input to the materiality assessment, when identifying IROs (i.e., refer to [chapter 3.2 step B](#) of this Guidance):
- (a) the undertaking has activities that do or do not comply with the criteria for substantial contribution, including Capex plans in place; and
 - (b) whether these activities comply or not with one or more of the DNSH criteria.

Example of an undertaking constructing new buildings

225. An undertaking constructs new buildings which is a Taxonomy eligible activity. The SC criteria for the Climate Change Mitigation (CCM) objective set taxonomy-related thresholds for, among others, the Primary Energy Demand (PED) of the building. If the new buildings fulfil the SC criteria, the economic activity has a reduced negative impact or even positive. If they do not comply with the SC criteria, the impact on the SC objective can be reduced or be positive with a Capex plan and could become an opportunity. Without the Capex plan, the impact would instead be either actual or potential negative on the SC objective. The impact of the activity on the SC objective could be an input to the list of identified potential impacts and/or opportunities in the materiality assessment.
226. Further, the DNSH criteria for the biodiversity objective (BIO) require the new building not to be constructed on certain types of land. As this new building is built on arable land, the building does not comply with the DNSH criteria for the BIO objective. This information therefore could be included as an input to step B of the materiality assessment.

Example of a manufacturer of electrical equipment

227. An undertaking manufactures high, medium, and low voltage electrical equipment for electrical transmission and distribution. This is a Taxonomy eligible activity. As an enabling activity, the SC criteria for the Climate Change Mitigation objective set taxonomy-related requirements, among others, for low voltage circuit breakers, switchgears, switchboards, panel boards to meet certain energy efficiency standards. The undertaking does not comply with these requirements. As the manufacturing of high, medium, and low voltage electrical equipment is an enabling activity, it cannot automatically be assumed that the activity has potential or actual negative impact on the SC objective; hence, this is information that could be used as an input to the materiality assessment.

The DNSH criteria for the Pollution Prevention and Control (PPC) objective for this activity require the undertaking to comply with all elements of Appendix C. As the activity fails to comply with one of the requirements in Appendix C, the undertaking may have potential or actual negative impact on the PPC objective, and this could be an input to Step B of the materiality assessment.

