JUNE 2024

ESRS PERSPECTIVES: MATERIALITY ASSESMENT

SUMMARY OF VIEWS

The European Sustainability Reporting Standards (ESRS) have been effective since 1 January 2024 for the first companies in the Corporate Sustainability Reporting Directive's (CSRD) scope. The ESRS introduce a new reporting framework in Europe, and include many new concepts which stakeholders may find challenging.

Accountancy Europe has contributed to every step of the ESRS' development and finalisation, including to EFRAG's guidance. In this series of publications, we summarise the ESRS' provisions on these concepts and share our views on ESRS aspects that merit further guidance and clarification. To provide background information for our views, we have summarised the existing ESRS' provisions on these concepts and where applicable, incorporated EFRAG's guidelines. We have not interpreted or provided guidance on these matters.

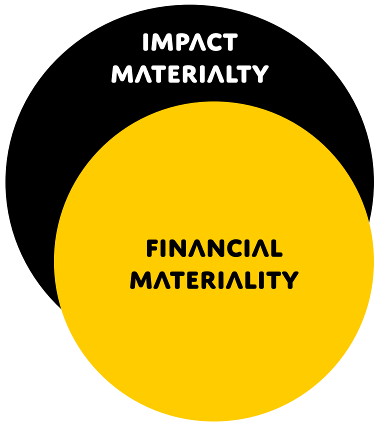


Figure 1

DOUBLE MATERIALITY

BACKGROUND INFORMATION

GENERAL RULE AND EXCEPTIONS

For ESRS' purpose, material information needs to meets the criteria of double materiality, which is the union of impact materiality and financial materiality (see Figure 1)[1]. A sustainability matter can be material from an impact perspective or a financial perspective, or both.

A materiality assessment process will help identify the material impacts, risks and opportunities (IROs) as well as the respective material information to disclose. IROs will need to be assessed for both the company's own operations and the value chain as well as in the short-, medium- and long-term.

[1] The figure is not indicative of the size or overlap of the circles.

The general rule in ESRS is that the (double) materiality assessment informs the information to report. However, the following are exceptions to this general rule:

1. ESRS 1 *General requirements* (ESRS 1), and ESRS 2 *General disclosures* (ESRS 2) are mandatory and the disclosures in ESRS 2 must be provided regardless of the materiality assessment

2. if in any topical ESRS, there is an IRO-1 *Description of the process to identify and assess material impacts, risks and opportunities* disclosure requirement, that information will be disclosed despite the results of the materiality assessment

> ESRS 2 Appendix C lists all the disclosure requirements in all ESRS, including IRO-1 ones.

3. if ESRS E1 *Climate change* is deemed not material, the company shall disclose a detailed explanation of the conclusions of its materiality assessment regarding climate change

4. if an EU legislation-related datapoint is deemed not material, the company shall state “not material” for each of these datapoints.

> ESRS 2 Appendix B lists all the EU legislation-related datapoints.

EFRAG issued the non-authoritative [IG1 Materiality Assessment Implementation Guidance](#) (EFRAG’s MA IG) to support application.

MAKING MATERIALITY ASSESSMENTS

ESRS do not mandate a specific process to follow as it will vary depending on companies’ respective characteristics. However, companies can draw inspiration from the list of sustainability matters (see paragraph AR 16 of Appendix A in ESRS 1) or even the good practices shared in EFRAG’s MA IG (see Figure 2).

IMPACT PERSPECTIVE

In assessing IROs from the impact perspective, the company looks for actual or potential, positive or negative impacts in the short-, medium- and long-term.

To make that assessment, there are 4 possible combinations, composed of the respective elements/criteria of scale[2], scope[3], irremediable character[4] (together referred to as “severity”) and likelihood (see Figure 3). The company assesses whether and how it meets each of these criteria by setting its own thresholds for them.

Figure 2

MATERIALITY ASSESSMENT POSSIBLE STEPS

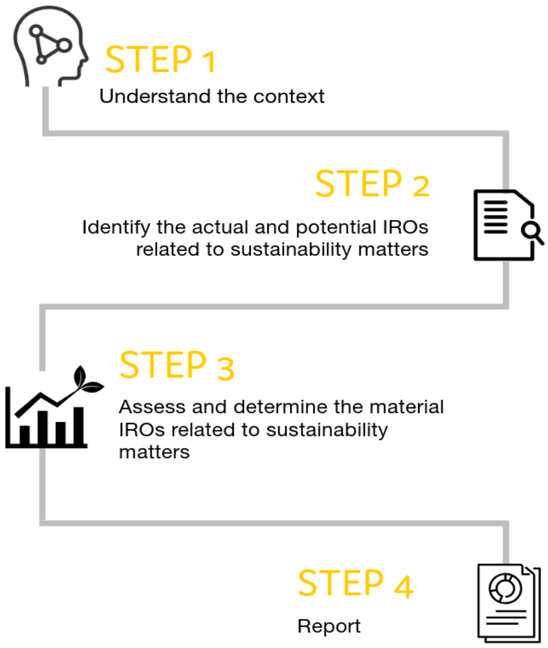
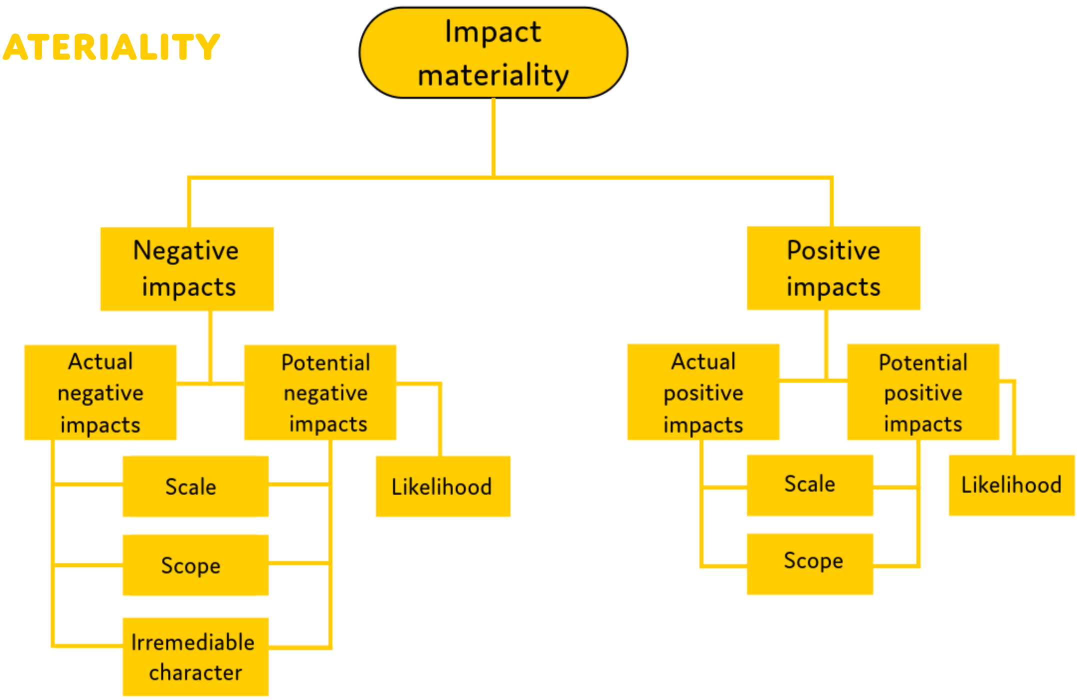


Figure 3

IMPACT MATERIALITY MAP



[2] ESRS define scale as “*how grave the negative impact is or how beneficial the positive impact is for people or the environment*”.

[3] ESRS define scope as “*how widespread the negative or positive impacts are. In the case of environmental impacts, the scope may be understood as the extent of environmental damage or a geographical perimeter. In the case of impacts on people, the scope may be understood as the number of people adversely affected*”.

[4] ESRS define irremediable character as “*whether and to what extent the negative impacts could be remediated, i.e., restoring the environment or affected people to their prior state*”.

FINANCIAL PERSPECTIVE

In assessing from the financial perspective, the entity looks for sustainability risks and opportunities that over the short-, medium- and long-term trigger financial effects to the entity in terms of financial performance, financial position, cash flows, access to finance and cost of capital. Information is considered material from a financial perspective if it could influence the decisions of the primary users of financial reports (e.g., in providing resources to the entity).

OUR VIEWS

We welcome the ESRS and EFRAG's MA IG and appreciate that many of our suggestions for improvements have been taken into account. However, we believe that the following key matters need further clarification and interpretation by the European Commission (EC), as well as guidance, which could be provided by EFRAG.

VALUE CHAIN IN THE MATERIALITY ASSESSMENT

The company will need to determine material IROs in the upstream and downstream value chain in addition to its own operations. We appreciate EFRAG's IG2 *Value Chain Implementation Guidance* includes this matter, but, call for further guidance and examples on incorporating the value chain in the materiality assessment and determining how far to go in the value chain for this assesment.

GROUP MATERIALITY ASSESSMENTS FOR CONSOLIDATION PURPOSES

EFRAG's guidance on this topic is very useful, particularly as the ESRS do not address groups or consolidation in details. However, more examples would help to further illustrate the guidance. In addition, it is important to clarify and provide more guidance and examples on consolidating, aggregating and disaggregating IROs as these elements remain open to interpretation.

MATERIALITY ASSESSMENT FOR SOCIAL TOPICS

Experience in reporting on social matters is relatively new when compared to reporting on environmental topics. Assessing double materiality for these topics, both for own operations and value chain is also new, particularly when adding human rights considerations to the elements of the assessment. Guidance and examples on this matter could help stakeholders align their practices and expectations.

FINANCIAL PERSPECTIVE OF DOUBLE MATERIALITY

More guidance and examples on identifying, assessing and reporting on material risks and opportunities, developed in collaboration with the International Sustainability Standards Board (ISSB) (see below), would be useful. Particularly, it is important to:

- emphasise the relationship between IROs, particularly for impacts that give rise to risks and opportunities
- clarify whether risks and opportunities are to be assessed before actions, and
- understand how to navigate "opportunities", which borders with sensitive information.

A PROCESS FOR MORE COMPLEX COMPANIES

Financial institutions, conglomerates and multinational enterprises have very complex own operations and value chains. Without clear boundaries, these companies' materiality assesements may include the whole world. We welcome further guidance for these industries and look forward to the sector-specific standards which could help ensure consistency and comparability but also align expectations.

ALIGNMENT WITH ISSB AND GRI PRACTICES

The ESRS have been aligned with the ISSB's standards as well as the Global Reporting Initiative's (GRI) standards for their respective aspects. However, we regret such collaboration did not take place for this guidance. EFRAG and the EC, ISSB and GRI should continuously work together in aligning practices in addition to standards as it will minimise compliance costs and lead to efficiencies in processes and reporting.

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