Approach to materiality in sector agnostic ESRS

Issue Paper

Background

1   On the 15 August 2022 EFRAG SRB discussed the approach to materiality in sector agnostic ESRS, which is relevant for the finalization of the 13 EDs in Set 1. No technical decisions were taken at the meeting.

2   **Agenda Paper 06.02** provided for this session is the supporting material prepared for the SRB discussion and is also relevant for this SR TEG discussion.

3   In the meeting on the 15 August the SRB requested that the SR TEG discusses:

(a)   a combination of the Approaches 3 and 4 described in Agenda Paper 06.02, as a possible way forward;

(b)   whether the public consultation outcome suggests that views against the rebuttable presumption are justified by a rejection of the underlying concept of by the burden associated to the 'explicit' approach (this will be possible after the completion of the analysis of the comments);

(c)   advantages and disadvantages of the explicit and implicit approach to the rebuttable presumption, to support a future decision on this aspect.

Objective of this session

4   EFRAG SR TEG members will provide their inputs on:

(a)   the approaches proposed in agenda paper 06.02;

(b)   how to combine Approach 3 and 4 as a possible way forward;

(c)   advantages and disadvantages of explicit and implicit approaches.

5   It is not the purpose of this meeting to identify the list of DRs that would be material in all cases (non-subject to the rebuttable presumption/materiality assessment). It is not the purpose of this meeting to identify possible simplifications to the number of DRs in the EDs.

6   No decisions will be taken at this meeting.

Combining approach 3 and 4

7   <u>Approach 3</u> has the following characteristics:

(a)   A number of DRs would be mandatory in all cases.

(b)   Companies would still have space for materiality assessment (using the rebuttable presumption) for a pre-defined list of additional DRs.

8   For point (a), a criterion needs to be defined in order to identify the list of non-rebuttable items. As an illustration, during the consultation, the following has been suggested as a possible list of mandatory items: CCS, SFDR, Climate, Workforce, for the other topics: report IROs/policies/action plans and few KPIs. Another criterion could be the alignment with international standards. A detailed analysis and discussion will be needed (benefitting from the insights of the full consultation feedback), in order to develop few possible alternative scenarios for this mandatory list.

9   With reference to point (a), the key advantage of a list of items that are mandatory in all cases is to promote comparability and to support relevance of the reporting, reducing the space for possible omissions, in particular considering the ambitions of the CSRD to overcome the limitations of the current information provided under the NFRD requirements (notably the lack of sufficiently specific reporting standards).

10   For point (b) the key advantage of a list of items that are subject to the rebuttable presumption (i.e. to be reported if they are material for the undertaking) is to allow for an entity-specific materiality assessment. The undertaking would focus on what is material considering its specific facts and circumstances, but at the same time the materiality assessment would benefit from a clear starting point (the 'rebuttable' disclosure requirements in the sector-agnostic ESRS) that is common to all the undertakings in all the sectors and that derives from the materiality assessment performed by the Standard Setter.

11   <u>Approach 4</u> has the following characteristics: enhance the rebuttable presumption.

   (a)   With reference to implicit versus explicit approach, see the next section of this paper. For the time being, in the development of an approach that combines Approaches 3 and 4 we would consider that both implicit and explicit approaches are possible.

   (b)   A clarification that materiality assessment is for sustainability mattes and aspects of a sustainability topic and not for materiality of disclosure requirements

         Change wording in ESRS 1/2 and other places to "materiality of the information" from "materiality of the disclosure requirement" for all instances where the latter term is used.

   (c)   A clarification that rebuttable is only based on "the materiality assessment" and not on other factors (e.g. based on costs for the undertaking).

   (d)   A clarification that materiality assessment is not intended to pursue proportionality purposes.

12   <u>Based on the above, the proposed combination of Approach 3 and 4 would have (i) a list a mandatory items, plus (ii) a list of items applicable to all the undertakings across all sectors, but subject an enhanced rebuttable presumption (amended as per paragraph 12).</u>

Phase-in

13   <u>Phase-in: the following possible components could be combined,</u> in order to address the concerns of the burden and complexity of all the items becoming effective at the same effective date:

   (a)   <u>List of mandatory items (outside the scope of the rebuttable presumption):</u> a possibility could be to allow a phased-in effective date, with a number of these items to be effective in the first period and others becoming effective one or two years later, remaining optional in the first year.

   (b)   <u>List of items in scope of the rebuttable presumption:</u> a possibility could be to allow a phased-in effective date also for these items (this would alleviate the burden to assess their materiality in the first one or two years and it would allow for a phased-in implementation), with a number of these items to be effective in the first period and others that becoming effective one or two years later, remaining optional in the first year.

   (c)   <u>Possibility to amend Set 1 in future periods to add new requirements:</u> a possibility could be to omit from Set 1 a number of items that would be added subsequently in Set 1 by a specific amendment (to be issued by Delegated Acts). The complexity of this approach is that the amendment will require a public consultation and decision-making process. In addition, EFRAG

workplan will be defined considering the priorities in each period and in theory other competing activities could delay the implementation of this amendment. Finally, this approach has the drawback that if not included in the text of Set 1 issued in the Delegated Act, the items postponed to future amendments would not be considered by undertakings in their planning and resourcing.

"Implicit" and "explicit" statement for non-material items

Approach in ESRS 1 and 2

14   The rebuttable presumption in ESRS 1 can be applied at two possible level and already combines the two approaches (explicit and implicit):

(a)   at an aggregate level, the undertaking can conclude that (i) all the DR or (ii) a group of DR related to a specific aspect covered by one or more of the 11 topical ESRSs are not-material. In this case, the <u>explicit approach</u> is required (i.e. the undertaking has to disclose which ESRS or group of DR has been omitted as assessed to be not material);

(b)   at a more granular level, the undertaking may omit individual disclosure requirements or individual data points that it assesses to be not-material; in this case there is an <u>implicit assumption</u> of non-materiality of these items, but not a requirement to disclose their list.

15   Paragraph 77 (c) of ESRS 2 requires that '*a list of ESRS or group of disclosure requirements related to a specific aspect covered by an ESRS that are complied with a "not material for the undertaking" disclosure, with a clear indication as to the application of the rebuttable presumption and the reason why it is rebuted (see also chapter 2.2. of ESRS 1).'*

16   *Advantages and disadvantages of the explicit and implicit approach*

	IMPLICIT	EXPLICIT
Advantages	• This approach avoids to create the burden of disclosing the list of items omitted as not-material and the rationale. • This approach avoids to promote the inclusion in the report of immaterial information. • Consistent with the IFRS approach.	• Promotes a more robust application of the materiality assessment, as there is an explicit declaration by the management of what has been assessed as not-material. • In the initial phase when the new requirements are applied for the first periods, it may support a better understanding of the outcome of the materiality assessment, of how it compares with that of the peers. It may also help users to get familiar with the overall content of the ESRS.
Disadvantages	• Missing an explicit declaration by the management of what has been assessed as not-material, this	• Disclosing the list of items omitted as not-material and the rationale creates an

	advantage does not create a specific incentive to a robust application of the standards. • In the initial phase when the new requirements are applied for the first periods, this approach does not support a better understanding of the outcome of the materiality assessment, of how it compares with that of the peers. Nor it helps users to get familiar with the overall content of the ESRS.	additional reporting burden. • The list of items and rationale is not necessarily a material information to provide: this approach promotes presentation of immaterial information and may obscure other material information. • Not-consistent with the IFRS approach.

17   For the purpose of this analysis, we consider a system where the materiality assessment/rebuttable presumption is applicable to an appropriate set of items (i.e. the materiality assessment starts from a sector-agnostic disclosure set of requirements identified as material by the standard-setter based on the requirements of the CSRD). The undertaking is expected to have reasonable and supportable evidence to justify the omissions, irrespective of the approach being explicit or implicit, for internal purposes (supervisory board, auditors, regulators). As such, the cost/burden to collect the reasonable and supportable evidence is not a specific disadvantage of one of the two approaches.

IFRS S1 EDs and GRI

18   IFRS do not require to disclose a list of non-material topics / issues.

19   The GRI approach is described below and further detailed in the Appendix to this paper:

(i)   Some disclosure requirements in GRI are not subject to the materiality assessment.

(ii)   Sector agnostic topics / disclosures are subject to the materiality assessment (i.e. all topics / disclosures not considered likely material topics by applicable sector specific standards). They do not require a "explicit" not-material statement.

(iii)   Only GRI topics considered material by the standard setter for an <u>applicable sector</u> and disclosures out of the list GRI sector topics considered material by the undertaking are subject to an "explicit" non-materiality disclosure. As currently only a limited number of sector specific GRI exist (Oil and Gas, Coal, Agriculture, Aquaculture and Fishing) the "explicit" disclosure can - as of now - be considered the exception in GRI sustainability reporting and not the norm.

20   ESRS are based on sector-agnostic disclosure requirements mandated by the standard-setter based on the requirements of the CSRD. This is not entirely comparable to GRI and IFRS both being to a large extent / completely based on a materiality assessment.

Questions to EFRAG SR TEG

21   Do you consider that there are other possible approaches to materiality than those illustrated in Agenda Paper 06.02?

22   Would you support an approach that combines elements of Approaches 3 and 4, as described in this paper? If not, which alternative would you suggest to consider?

23   Which criterion/criteria would you suggest in order to define the list of items that are always mandatory/outside the scope of the rebuttable presumption?

24   Would you support a combination of (a) and (b) described in paragraph 14 above, as a possible way forward for the phasing-in, jointly with the approach that combines elements of Approaches 3 and 4 described in this paper?

25   Do you agree with the description of advantages and disadvantages of the implicit and explicit approach in paragraph 17? Have you identified additional elements to add to this analysis?

26   In the context of an approach that combines a list of mandatory items (outside the scope of the rebuttable presumption/materiality assessment) and a list of items assessed as material by the Standard Setter (inside the scope of the rebuttable presumption/materiality assessment), do you support an explicit or implicit approach? Why?

27   When considering the explicit approach, an alternative could be to require the disclosure of the list of ESRS and groups of DRs related to a specific aspect covered by an ESRS that have been omitted as not-material, but do not require to include the reasons for the omission. This alternative could promote a compromise in order to keep the advantages of an explicit approach, without excessive burden. Would you consider this as a possible approach to propose?

28   Do you have any other observation on the topics covered in this paper?

Appendix: GRI approach

29   GRI requirements are as follows:

(a)   GRI consist of universal, sector and topical standards. According to the most recent update three GRI sector standard exist: (Oil and Gas, Coal, Agriculture, Aquaculture and Fishing). Overall 40 sector-specific standards are envisaged.

(b)   **Material topics** (excluding those from the list of "likely material topics" of GRI Sector Standards, see (c) below) do not require an explicit materiality statement.

"The organization shall: a) report disclosures from the GRI Topic Standards for each material topic. …

For each material topic, the organization **needs to identify disclosures from the GRI Topic Standards to report**. The organization is required to report only those disclosures **relevant to its impacts in relation to a material topic**. The organization is not required to report disclosures that are not relevant.

There is **no requirement for a minimum number of disclosures** to report from the Topic Standards. The number of disclosures that the organization reports is based on its assessment of which disclosures are relevant to its impacts in relation to a material topic.

The organization may need to use more than one Topic Standard to report on a material topic. In addition, not all disclosures in a Topic Standard may be relevant for the organization to report. (GRI 1: Foundation 2021, Requirement 5)

(c)   However, for the list of **likely material topics of a Sector Standard** not considered material by the undertaking GRI requires an "explicit" statement of non-materiality of the **topics**:

"If the organization determines a topic in an **applicable Sector Standard** to be material, the Sector Standard helps the organization identify disclosures to report information about its impacts in relation to that topic. For each likely material topic, the Sector Standards list disclosures from the GRI Topic Standards for organizations to report. If any of the Topic Standards disclosures listed in the Sector Standards are **not relevant** to the organization's impacts, the organization is **not required to report these**. **However**, the organization is required to list these disclosures in the GRI content index and **provide 'not applicable' as the reason for omission** for not reporting the disclosures. The organization is also required to explain in brief why the disclosures are not relevant to its impacts in relation to the material topic." (GRI 1: Foundation 2021, Requirement 5)

(d)   Also, for GRI Topic Standard **disclosures** for a topic **from the applicable GRI Sector Standard(s) determined material for the undertaking** an explicit statement of non-materiality of the disclosure is required.

"… when the organization does not report GRI Topic Standard disclosures for a material topic from the applicable GRI Sector Standard(s), a list of the disclosures and the required reason for omission." (GRI 1: Foundation 2021, Requirement 7)

(e)   Four reasons for omission are available: 1. Not applicable, 2. Legal prohibitions, 3. Confidentiality constraints, 4. Information unavailable / incomplete. (GRI 1: Foundation 2021, Requirement 6).

(f)   Reasons for omission are permitted for all disclosures from the GRI Standards except for:

- Disclosure 2-1 Organizational details

- Disclosure 2-2 Entities included in the organization's sustainability reporting

- Disclosure 2-3 Reporting period, frequency and contact point

- Disclosure 2-4 Restatements of information
- Disclosure 2-5 External assurance
- Disclosure 3-1 Process to determine material topics
- Disclosure 3-2 List of material topics