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Implementation guidance for the materiality assessment

Disclaimer

This implementation guidance is non-authoritative and accompanies ESRS but does not form part of it. This means that if anything in this guidance appears to contradict any requirement or explanation in ESRS, ESRS takes precedence. This implementation guidance is issued following EFRAG's due process for such non-authoritative documents and under the sole responsibility of EFRAG.



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Summary in 12 key points

1. The materiality assessment is the process by which the undertaking determines material information on sustainability impacts, risks and opportunities. This is achieved by the determination of material matters and material information to be reported in the undertaking's sustainability statement. The performance of a materiality assessment based on objective criteria is pivotal to sustainability reporting which shall include relevant and faithful information about all impacts, risks and opportunities (IROs) across environmental, social and governance matters determined to be material from the impact materiality perspective or the financial materiality perspective or both.
2. The assessment covers 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 an impact, risk or opportunity related to a sustainability matter has been identified as material, the undertaking (a) refers to the requirements in the related ESRS to identify the relevant information to be considered for disclosure on the matter or (b), when the impact, risk or opportunity is not covered or insufficiently covered by the ESRS, shall provide a relevant entity-specific disclosure. Relevance is the criterion to support the identification of the information to be disclosed. Relevance is based on (a) the significance of the information in relation to the matter it depicts or (b) its decision-usefulness.
4. The determination of the information to be reported depends on whether the information relates to (a) policies, actions and targets; or (b) metrics. For policies, actions and targets, information shall be disclosed according to the Disclosure Requirements, or it shall be stated that the undertaking does not have policies, actions and/or targets. Metrics are subject to materiality assessment whereby these are omitted if assessed as not material. Such an omission is in itself useful sustainability-related information. Omitting datapoints derived from EU legislation based on materiality requires stating explicitly that they are not material. ESRS 2 Disclosure Requirements which address cross-cutting matters are to be reported in all cases (irrespective of the outcome of the materiality assessment).
5. ESRS do not mandate a specific process or sequence of steps to follow when performing the materiality assessment, as this is left to the judgement of the undertaking which has to define the process that better reflects its facts and circumstances:
6. As an illustration, a materiality assessment that would meet the requirements of ESRS could include the following steps:
 - a. understanding the context;
 - b. identification of actual and potential impacts, risks and opportunities related to sustainability matters;
 - c. assessment and determination of the material impacts, risks and opportunities 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 that are 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. Equally, ESRS do not mandate specific behaviour on stakeholder engagement and do not pre-empt the content of the CSDDD currently being defined in the EU legislative process,
8. To assess the materiality of impacts for reporting purposes, the undertaking assesses them against criteria of severity and likelihood and sets 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. To assess their materiality, appropriate quantitative and/or qualitative thresholds based upon anticipated financial effects in terms of performance, financial situation, cash flows, access to finance and cost of capital are used.



10. An assessment performed under GRI constitutes a good basis for the assessment of impacts under ESRS. The due diligence process, as defined in 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. Reflecting the equivalence of the scope of financial materiality in ISSB standards and ESRS, an undertaking that applies ESRS is expected to be able to comply with the identification of the sustainability related information on risks and opportunities under IFRS.
12. Following the performance of the materiality assessment process, the undertaking shall disclose:
 - a. the process to identify and assess its material impacts risks and opportunities (ESRS 2 IRO1),
 - b. the interaction of impacts, risks and opportunities with its strategy and business model (ESRS 2 SBM-3), and
 - c. the Disclosure Requirements under ESRS covered by its sustainability statement (ESRS 2 IRO2).

Subject to change



1 Introduction

13. 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” 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 ESRS, those requirements prevail.
14. The content of this document has been developed by EFRAG on the basis of the July 2023 Delegated Act on 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”).
15. This guidance should be read as illustrative only. When this guidance describes a specific approach or methodology that is not detailed in the Delegated Act other alternative approaches compliant with the Delegated Act are also possible.
16. 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.
17. 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 *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.
18. Finally, this guidance acknowledges that market practice is currently developing for double materiality assessment and that there is no single solution for all undertakings in terms of designing processes and adopting methodologies. Hence, this guidance is aimed at providing tools and mechanisms for undertakings to apply the materiality assessment requirements and disclosures set out in ESRS while taking full account of their specific facts and circumstances, including their business model, strategy, structure, complexity, governance and other contextual information.
19. This Guidance 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.
20. Acronyms used in this document are:
 - a. CSRD – Corporate Sustainability Reporting Directive;
 - b. ESRS – European Sustainability Reporting Standards;
 - c. CSDD – Corporate Sustainability Due Diligence Directive;

- d. GHG protocol – Greenhouse gases protocol;
- e. GRI – Global Reporting Initiative; and
- f. ISSB – International Sustainability Standards Board.

2 The ESRS approach to materiality

21. ESRS require that the sustainability statement include sustainability information related to material impacts, risks and opportunities identified through a materiality assessment process that applies the principles of double materiality.
22. Double materiality has two dimensions: impact materiality (covering material information about the undertaking's impacts on sustainability matters) and financial materiality (covering material information about risks and opportunities for the undertaking resulting from sustainability matters). The terms "material" and "materiality" are used throughout ESRS to refer to double materiality, unless specified otherwise.
23. The materiality assessment serves to identify the material information to be included in the sustainability statement. During the materiality assessment process, the undertaking shall identify all material impacts, risks and opportunities across the environmental, social and governance topics in their own operations as well as in upstream and downstream value chain, and consequently also exclude those topics that are not material. If the process is not appropriately designed, it may expose the undertaking to incomplete reporting (i.e., material impacts, risks or opportunities not being disclosed). This process is the starting point to determine the material information to be disclosed in the sustainability statement on these material impacts, risks and opportunities.
24. If, for management purposes, the undertaking identifies a large number of impacts, risks and opportunities, it may prioritise them over time in a certain order. However, for reporting purposes this prioritisation should not result in material impacts, risks and opportunities being excluded, in particular when they are not addressed or fully addressed by the undertaking through policies, targets and action plans. This is because the undertaking shall report on all its material impacts, risks and opportunities irrespective of whether actions have been undertaken or are planned to address them.
25. The materiality assessment should be based upon supportable evidence and rely to the maximum extent possible on objective information. It shall reflect the implementation of the impact materiality and financial materiality criteria specified in the ESRS (ESRS 1 chapters 3.4 and 3.5).
26. The ESRS require undertakings to disclose the materiality assessment process and its outcome. This includes the following information with respect to the process: methodologies and assumptions applied, the focus and extent of the process, inputs, and where certain judgements have been made by the undertaking and the use of thresholds (ESRS 2 - IRO 1).
27. For the sustainability statement to meet the required characteristics of quality (Appendix B of ESRS 1), the process, the way the criteria (ESRS 1 chapters 3.4 and 3.5) are applied, the thresholds and the conclusions of the materiality assessment should be consistent with internal and other external reporting, business operations and sustainability management policies and actions, including those that are put in place to fulfil obligations related to sustainability related laws and regulations.
28. The undertaking is not required to report on all matters described in the topical ESRS, but only on those that are material.
29. The undertaking may briefly explain the conclusions of its materiality assessment in relation to the omitted topic or topics. The undertaking shall provide explanations if it concludes that it has no material impacts, risks and opportunities with respect to climate change and therefore omits Disclosure Requirements in ESRS E1 Climate Change. The undertaking shall also report on material matters that are not covered or are covered insufficiently in the topical ESRS, according to the requirement provided in the ESRS 1 for entity-specific information.
30. Once the undertaking has identified the material matters to be reported on, it assesses the materiality of the information to determine the information to be reported on each material matter (ESRS 1 paragraphs

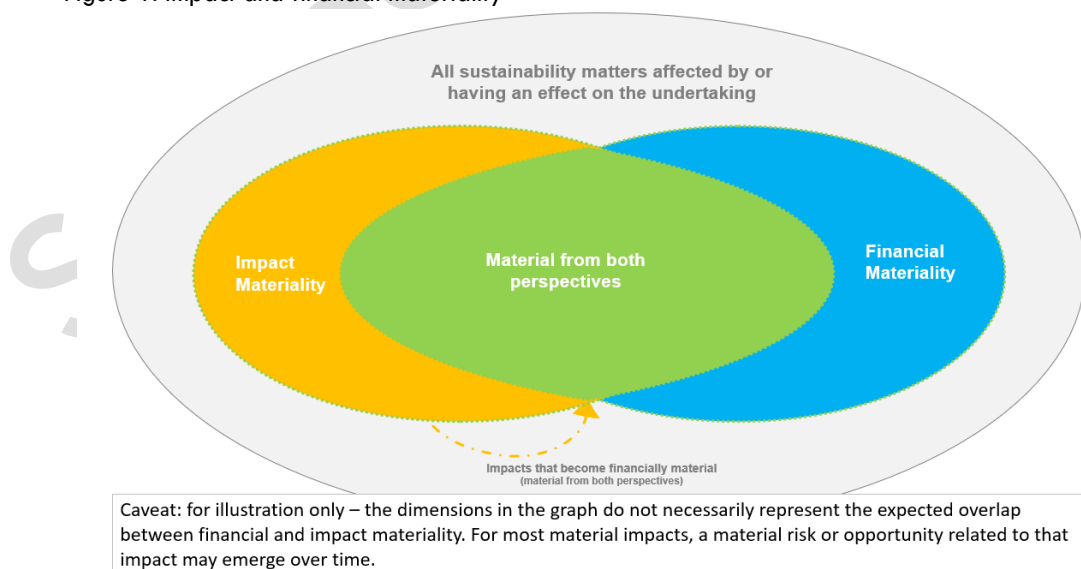


30, 31, 33 and 34)¹. The concept of materiality of information is a step that follows the materiality assessment that leads to the identification of material matters to be reported on and is applied to the information to be disclosed at a more granular level, i.e., at Disclosure Requirement or datapoint level.

2.1 Implementing the concept of double materiality

31. The CSRD establishes that sustainability reporting shall be based on the principle of double materiality (referred to in this document as “materiality”). There are two dimensions to double materiality: impact materiality and financial materiality when identifying the information to be disclosed. A sustainability matter can be material from an impact perspective or from a financial perspective or from both (see ESRS 1 chapter 3).
32. ESRS include a definition of these two materiality dimensions, “a sustainability matter is material from”:
 - a. “An impact perspective when it pertains to the undertaking’s material actual or potential, positive or negative impacts on people or the environment over the short-, medium- and long-term. Impacts include those connected with the undertaking’s own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships.” (ESRS 1 paragraph 43); and
 - b. “a financial perspective if it triggers or could reasonably be expected to trigger material financial effects on the undertaking. This is the case when a sustainability matter generates 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.
33. Impact materiality and financial materiality are often intertwined. The undertaking’s impacts on people or the environment, as well as changes to strategy, including investments, and management decisions made to address such impacts, often give rise to risks and opportunities for the undertaking.

Figure 1: Impact and financial materiality



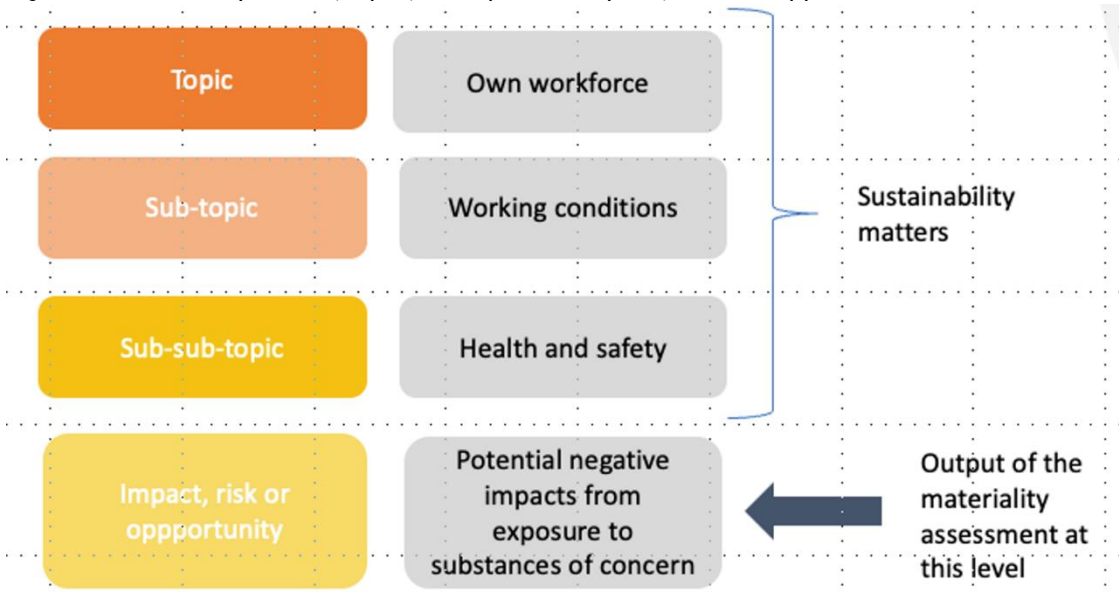
¹ The undertaking may also refer to the flowchart in ESRS 1 appendix E for an illustration of this step.

34. For most material impacts, a material risk or opportunity related to that impact may emerge over time. For example:
- a. an oil and gas undertaking identifies a material negative impact that arises from not performing the consultation or reaching an agreement with indigenous' people to use their land for the extractions and to relocate the community. At the reporting date, the undertaking does not expect that the indigenous community will initiate protests. However, such indigenous community may at a later stage initiate protests that could halt the production of oil and gas at that site and cause material costs for the undertaking due to the days lost to production or the abortion of the project; and
 - b. an undertaking has a number of cases of gender discrimination when promoting employees during the current reporting year. At the reporting date, the undertaking does not expect that the employees pursue legal proceedings. However, such group of employees, individually or as a whole, pursues at a later stage legal proceedings on the grounds of gender discrimination and seek financial compensation within the medium-term and cause reputational damage to the undertaking.
35. Beyond risks and opportunities deriving from impacts, material risks and opportunities also arise in the absence of material impacts connected to the undertaking, in particular when they are due to dependencies on the availability of natural and human resources. For example:
- a. an undertaking is active in organic agriculture which has dependencies on pollinators. The number of pollinators is decreasing due to pesticide use by other agricultural entities in its vicinity;
 - b. an undertaking that has a factory that is running on renewable energy and, thus, does not produce GHG emissions, is in a location subject to coastal erosion and could be exposed to climate-related physical risks such as flooding or extreme weather;
 - c. an undertaking dependent on human resources may experience a high level of staff turnover caused by a local competitor hiring employees at a higher salary, despite the two undertakings having adequate working conditions and practices (i.e., not driven by a material impact) and therefore its operations may be dependent on the availability of human resources;
 - d. sustainability-related regulatory developments that address systemic risks may affect the prospects of the undertaking's business.
36. Impact materiality and financial materiality are two different concepts, however as illustrated above they are inter-related and the interconnections between them shall be considered. The undertaking is expected to exercise its judgement in organizing its materiality assessment, including on whether the two processes should be separate or should have common steps, however there is merit in maximizing procedural synergies between the two to avoid gaps.

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

37. Sustainability matters are defined in the delegated act glossary as environmental, social and human rights, and governance factors, including sustainability factors defined in Article 2, point (24), of Regulation (EU) 2019/2088 (i.e., SFDR).
38. The level of granularity of the matters to be considered ranges from topic level (for example, own workforce) to sub-topic level (for example, working conditions) and, in some cases, to sub-sub-topic level (for example, health and safety). As described in ESRS 1 paragraph 8, the three levels of granularity are collectively called sustainability matters (see ESRS 1 paragraph AR 16 for a full list of topics, sub-topics and sub-sub-topics). In particular:
- a. the goal of the materiality assessment is to identify the material impacts, risks and opportunities related to matters that are to be reported (ESRS 2 SBM 3);
 - b. the matter is assessed to be material when material impacts and/or material financial effects that arise from the matter are identified (ESRS 1 paragraph 43 and 49); and
 - c. for each material matter, the undertaking determines the information to be reported in accordance with the cross-cutting or topical standards (ESRS 1 paragraph 30).

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



39. The outcome of the materiality assessment is disclosed according to ESRS 2 SBM-3 *Material impacts, risks and opportunities and their interaction with strategy and business model*. The objective of ESRS 2 SBM-3 is to set requirements for the undertaking to disclose its material impacts, risks and opportunities identified at topic, sub-topic or sub-sub-topic level.
40. The undertaking shall disclose its material impacts, risks and opportunities 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, as per any other disclosure, the undertaking may aggregate information to the extent that it does not obscure material content (ESRS 1 chapter 3.7).
41. Given that double materiality considers both impact materiality and financial materiality, the undertaking needs to identify whether a topic, sub-topic or sub-sub-topic is material from any of the two perspectives, or both.
42. Once a matter has been identified as material, the undertaking refers to the requirements in the respective topical ESRS to identify the information to be disclosed on the matter (ESRS 1 paragraph 30 and 31). For example, health and safety could be material from a negative/positive impact, and/or risk, and/or opportunity perspective. If an undertaking concludes that health and safety of its own workforce is material due to the employees' exposure to harmful chemical substances, it shall provide information related to this sustainability matter following the requirements in Disclosure Requirements S1-1 *Policies*, S1-4 *Taking action*, S1-5 *Targets*, and S1-14 *Health and Safety metrics*. Similarly, if an undertaking concludes that pollution of water is material, it shall provide information related to this sustainability matter following the requirements of Disclosure Requirements E2-1 *Policies*, E2-2 *Actions and resources*, E2-3 *Targets*, E2-4 *Pollution of air, water and soil* and E2-6 *Anticipated financial effects from material polluted-related risks and opportunities*.
43. In addition, there could be 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. In such situations, as per ESRS 1 paragraph 11, the undertaking shall disclose additional entity-specific disclosures.

2.3 Criteria for the identification of material information

44. Assessing the materiality of information is a step that follows the materiality assessment 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 Disclosure Requirements or datapoints. ESRS 1 paragraphs 31, 33-35 set requirements on how to assess materiality of information.



45. The criteria to assess the materiality of information are based on relevance as described in ESRS 1 paragraph 31: (a) the significance of the information in relation to the matter it depicts or (b) its decision-usefulness. This is decision-usefulness for the primary users of general-purpose financial information (i.e., financial materiality focused) and/or for those users whose interest is on the undertaking's impacts (i.e., impact materiality). In practice, information that is material under perspective (b) (decision-usefulness) is in many – if not most - cases also material 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 an 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) is or can be the same in practice. In other cases, the information may differ (refer to FAQ 21).
46. 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), refer to ESRS 1 Appendix B.
47. ESRS 2 IRO 2 requires an explanation of how the undertaking has determined the material information to be disclosed in relation to the impacts, risks and opportunities that it has assessed to be material, including the use of thresholds and/or how it has implemented the criteria in ESRS 1 chapter 3.2 *Material matters and materiality of information*.

2.4 Scope of application of the materiality of information

48. 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.
49. 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 ESRS 2, chapter 4.2 *Minimum Disclosure Requirements on policies and actions* and chapter 5 *Metrics and targets*). If the undertaking has not adopted such policies, actions or targets, it is mandatory to state it, but no specific information is required, apart from an optional disclosure on the timeline to adopt such policies, actions or targets. (ESRS 1 paragraph 33). The datapoints in the Minimum Disclosure Requirements have been defined to depict the relevant information that a user would require to assess the policies, actions and targets in relation to a material matter. Conversely, 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 the undertaking is not required to include any information in relation to the datapoints prescribed by the Disclosure Requirements relating to the absent policies, actions, and/or targets.
50. The determination of information to be reported for metrics is informed by the assessment of material information. This is generally performed starting first at the level of the Disclosure Requirement, and second at the level of the related datapoints located either in the Disclosure Requirement² or, when applicable, in Application Requirements. When the information required by a Disclosure Requirement or a datapoint is assessed to be not material (as per criteria of ESRS 1 paragraph 31), and for datapoints not needed to meet the objective of the Disclosure Requirement, the undertaking does not disclose (*may omit*) such information (ESRS 1 paragraph 34).
51. The criteria to assess 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 is to ensure that entity-specific disclosures (a) meet the qualitative characteristics of information and (b) include all material information related to the four reporting areas.
52. The Disclosure Requirements 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 paragraph 31 refer to the '*applicable information*', so also to this case).

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

2.5 Datapoints derived from EU legislation

53. 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, specifying where they can be found in the statement and for those that are omitted as not material, reporting that the respective datapoint is not material.
54. Such datapoints are treated in the same way as any other datapoint for the purposes of assessing the information to be reported on a material matter, i.e., when they relate to policies, targets and actions they follow ESRS 1 paragraph 33 and when they relate to metrics, they follow ESRS 1 paragraph 34 whereby these are omitted if assessed as not material.

2.6 Considerations for upstream/downstream value chain

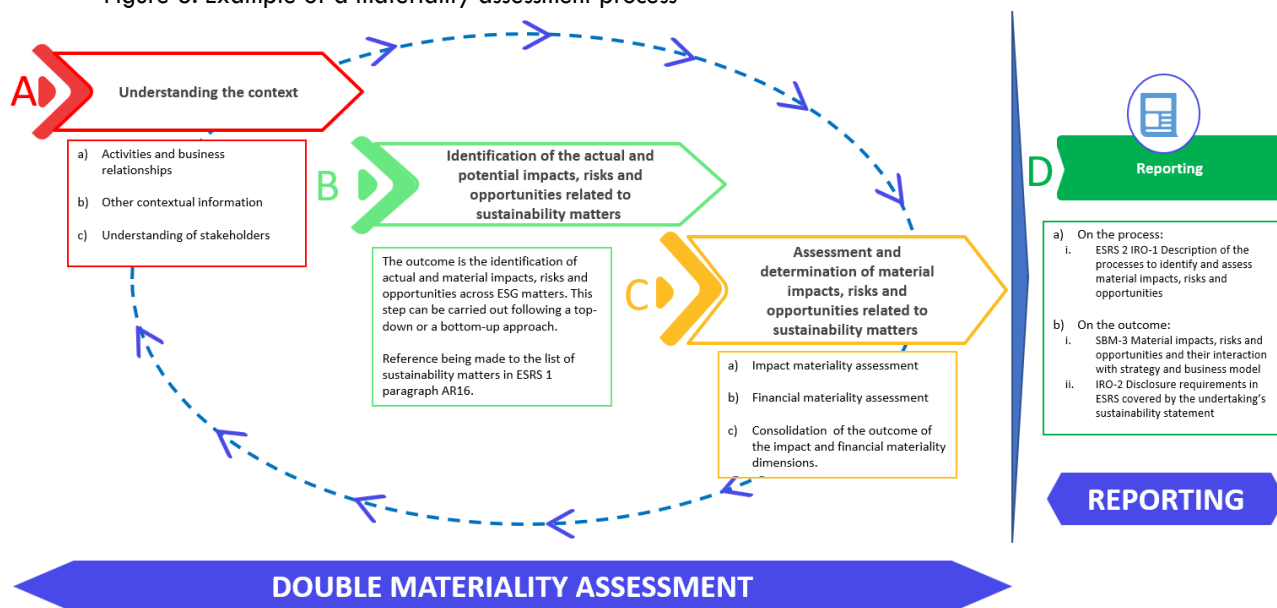
55. The materiality assessment is also used to identify material impacts, risks and opportunities connected with the undertaking through its direct and indirect business relationships in the upstream and/or downstream value chain (for further detail see Value Chain Implementation Guidance).

3 Materiality assessment – how is it performed?

56. 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 activities, organisational structure, location of operations or upstream and downstream value chains of all undertakings applying ESRS.
57. An undertaking, based on its specific facts and circumstances, shall design a process that is fit for purpose considering the requirements of ESRS 1 Chapter 3, and the disclosure requirements regarding the materiality assessment and its outcome (see ESRS 2 IRO-1, IRO-2 and SBM-3). Regardless of the process applied, an undertaking shall consider the full scope of environmental, social and governance matters (ESRS 1 paragraph AR16) under the double materiality approach.
58. The undertaking's materiality assessment shall reflect the impact and financial materiality perspectives, as well as interconnections between the two. This means that the undertaking does not need to perform two separate and independent materiality assessments. The identification of material impacts is generally a starting point since the financial materiality assessment shall consider the outcome of the impact materiality assessment (see ESRS 1 chapter 3.3 Double materiality) as material impacts may trigger material risks and opportunities. In addition, the undertaking shall also consider the possible matters that are financially material without being material from the impact perspective.
59. As an illustration, the process below includes four possible steps that undertakings may follow when conducting a materiality assessment aligned with ESRS:
 - Step A: Understanding the context
 - Step B: Identification of the actual and potential impacts, risks and opportunities related to sustainability matters
 - Step C: Assessment and determination of the material impacts, risks and related to sustainability matters
 - Step D: Reporting



Figure 3: Example of a materiality assessment process



60. Chapter 5.3 FAQ on the materiality assessment process has further guidance.

3.1 Step A: Understanding the context

61. In this step, the undertaking develops an overview of its activities and business relationships, the context in which these take place and the understanding of its key affected stakeholders. This overview provides key inputs to the undertaking for identifying its impacts, risks and opportunities.

Activities and business relationships

62. The aspects that are considered in relation to activities and business relationships relate to those disclosed in ERS 2 SBM-1 and are as follows:

- the analysis of the undertaking's business plan, strategy, financial statements and, when applicable, other information provided to investors;
- the undertaking's activities, products/services and the geographic locations of these activities;
- the mapping of the undertaking's business relationships and upstream and/or downstream value chain, including type and nature of business relationships;
- the identification of the perimeter of the information to be reported beyond its own operations: expansion of the perimeter to reflect impacts, risks and opportunities arising from business relationships upstream/downstream value chain; and

Other contextual information

63. There are other factors that can help identify particular sources of impacts, risks and opportunities such as:

- the analysis of the undertaking's relevant legal and regulatory landscape; and
- 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

64. This step is aiming at understanding which are the stakeholders that 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 stakeholder engagement in the materiality assessment) and what their views and interests are (this should be consistent with the disclosures in ERS SBM-2 Interests and views of stakeholders). Based on

this, the undertaking can identify its key affected stakeholders. To obtain this understanding, the following can be considered:

- a. the analysis of the existing stakeholder engagement initiatives (for example, those with the communication, investor relations, business management, sales and procurement teams of the undertaking);
- b. a mapping of affected stakeholders across the undertaking's activities and business relationships. It may be the case that separate groups of stakeholders can be identified per activity, product or service and are to be prioritised for a particular sustainability matter; and
- c. the definition of the stage of the materiality assessment process in which the engagement will take place. For example, the engagement could be to validate the list of identified material matters. Similarly, for impact materiality, the engagement could be focussed on the scale aspect of severity and on time horizons (i.e., short-, medium- or long-term).

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

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

66. In this step, the undertaking identifies the material impacts, risks and opportunities relating to environmental, social and governance matters across its own operations and 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.

67. 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 and sector-specific standards; currently, until the sector standards are issued, sector sustainability matters shall be identified and assessed as entity-specific. The available best practices and/or available frameworks and/or other reporting standards, such as the IFRS industry-based guidance and GRI Sector Standards, are possible sources of relevant disclosures (ESRS 1 paragraph 131 b) for entity-specific matters.

68. For each identified impact, risks or opportunity, the undertaking should consider, and where necessary determine, what these relate to (i.e., own operations, upstream or downstream value chain) and time horizon (short-, medium-, or long-term) as per ESRS 1 Chapter 6.4.

Top-down approach

69. In terms of process, an undertaking could start to identify the matters from the list of topics summarised in ESRS 1 paragraph AR 16. This list could then be completed by additional entity-specific matters that follow from either internal processes already in place (i.e., due diligence, risk management or grievance mechanisms) or external sources such as those described in para 63 above and stakeholder engagement.

70. The identified long list of matters could then be aggregated following the structure of ESRS 1 paragraph AR 16. Also, to note that some undertakings may use different terms to those in ESRS 1 paragraph AR 16 for the top-down approach and, hence, a further harmonisation of terms should be performed.

71. The approach detailed in para 67 above could typically be effective for undertakings that are new to preparing the sustainability statement and have not yet developed a full sustainability reporting roadmap. Alternatively, an undertaking could start from the matters as informed by existing reporting (e.g., GRI, due diligence, risk management) in place. In this case, the undertaking would compare the matters identified with the list of ESRS 1 AR16 for completeness.

72. For this top-down process, the undertaking would then identify any additional impact, risk and opportunity for each matter to complete the materiality assessment and disclose it according to ESRS 2 SBM-3.

Bottom-up approach

73. An undertaking may also decide to start from a list of impacts, risks and opportunities that it identifies from a review of its business model, strategy, own operations and upstream/downstream value chain and further research. This list would subsequently be linked to a list of matters that cover these IROs. For

example, an undertaking that has identified *social dialogue, collective bargaining and freedom of association* as not material on an individual basis may assess these three factors combined as material for the undertaking within working conditions.

74. Chapter 5.5 FAQ on aggregation/disaggregation provides further guidance on aggregation/disaggregation.

3.3 Step C: Assessment and determination of the material impacts, risks and opportunities related to sustainability matters

75. In this illustration, this is the last step of the materiality assessment process the outcome of which is the list of material impacts, risks and opportunities and which consolidates the results of the previous steps. This list will be the basis for preparation of the sustainability statement and the information provided therein. This may include the following:

3.3.1 Impact materiality assessment

76. The undertaking shall apply objective criteria set out under chapter 3.4 of ESRS 1 using appropriate quantitative and/or qualitative thresholds to assess the materiality of current and potential impacts, which is based on severity and, for potential impacts, also likelihood (see chapter 3.6 *Setting thresholds for impact materiality*).
77. Therefore, the undertaking shall go through the list of impacts defined in step B above and apply the criteria determined for severity, which 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.
78. Stakeholder engagement (including workers and their representatives) informs this step of the materiality assessment as key affected stakeholders could help assess, validate and ensure completeness of the final list of material impacts; in particular, for the scale and irremediable character determination and for the estimation of likelihood. Likewise, internal engagement with the undertaking's business functions and employees could also help to assess, validate and ensure completeness of the outcome.
79. Chapter 5.1 FAQ on *impact materiality* provides further guidance on impact materiality. See also chapter 4.3 *Leverage from international instruments of due diligence*.

3.3.2 Financial materiality assessment

80. Material risks and opportunities for the undertaking generally derive either from impacts or from dependencies. To assess their materiality, appropriate quantitative and/or qualitative thresholds based upon financial effects in terms of performance, financial situation, cash flows, access to and cost of capital are used.
81. 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 opportunities from step B above and apply a set of objective thresholds for likelihood and magnitude.
82. Reflecting the fact that most impacts give rise to financial risks and opportunities, the undertaking may in this step assess whether material financial effects do derive from the impacts identified above (including the outcome of step B). Beyond risks and opportunities associated to impacts, the undertaking shall also consider other sources of risks and opportunities, such as dependencies, changes in regulations or climate hazards, etc.

83. When applicable, the undertaking may compare the material risks and opportunities in the list prepared in step B to the ones used in its risk management process (for example, ERM³ processes), when the latter also covers sustainability risks, and estimate the likelihood of occurrence of the risks and opportunities or their related financial effects accordingly.
84. Engagement with the undertaking's business unit functions may be appropriate to assess, validate and ensure completeness of the list of material risk and opportunities together with investors of the undertaking and other financial counterparties (e.g., banks).
85. Once a matter has been assessed to be material from a financial perspective (and therefore to be reported on), the undertaking determines the information to be reported based on its materiality (see chapter 2.3 *Criteria for the identification of material 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.
86. Chapters 5.2 FAQ on financial materiality provides further guidance on financial materiality.

3.3.3 Consolidation of the outcome of the impact and financial materiality dimensions and consideration of their interaction

87. The objective of this last step is to consolidate the results of the previous steps and obtain the list of material impacts, risks and opportunities which will be the basis for the preparation of the sustainability statement. The analysis performed at material topic/sub-topic or sub-sub-topic level is to be converted into material impacts, risks and opportunities if this has not taken place previously.
88. Once the undertaking has assessed individual impacts, risks and opportunities based on appropriate thresholds and methodologies, it may aggregate the resulting material impacts, risks and opportunities for reporting purposes. The undertaking may also validate the aggregated double materiality results with management (to assess and validate the completeness of the list of material impacts, risks and opportunities).

3.4 Step D: Reporting

89. Following the performance of 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;*
 - b. ESRS 2 SBM-3 *Material impacts, risks and opportunities and their interaction with strategy and business model;* and
 - c. ESRS 2 IRO-2 *Disclosure requirements in ESRS covered by the undertaking's sustainability statements.* Paragraph 59 of ESRS 2 requires the undertaking to disclose how it has determined the material information to be disclosed, including thresholds and criteria used to assess such information.
90. Chapter 5.6 FAQ on reporting provides further guidance on reporting.

3.5 Role and approach to stakeholders in the materiality assessment process

91. For ESRS reporting purposes, stakeholders are classified into the following two groups as per ESRS 1 paragraph 22: affected stakeholders and users of sustainability statement.
92. ESRS clarify that the materiality assessment process is informed by the due diligence process laid out in the international instruments of due diligence, namely the OECD MNE and UNGP. ESRS 1 paragraph 24

³ Enterprise Risk Management, see https://docs.wbcsd.org/2018/10/COSO_WBCSD_ESGERM_Guidance.pdf

describes that engagement with affected stakeholders is central to the undertaking's due diligence and impact assessment, insofar that their perspectives inform the materiality process.

93. Engagement with affected stakeholders entails seeking input and feedback to understand their concerns and, in turn, evidence of actual or potential impacts on people and environment connected with the undertaking from those stakeholders that could be affected.
94. Consulting with affected stakeholders and incorporating their views into the materiality assessment process helps the undertaking to substantiate the perspectives of the affected stakeholder groups in determining how relevant the sustainability matters are for them. For example, engaging with the undertaking's employees or their representatives on health and safety matters. This includes feedback received from stakeholders within its ongoing engagement with them as part of the undertaking's business practices.
95. On impact materiality, the focus of the stakeholder's engagement could be on the scale (i.e., how grave the negative impact is or how beneficial the positive impact is for people or the environment – see ESRS 1 AR 10) and the time horizons when impacts are expected to materialise. The undertaking may engage with affected stakeholders in step B of the process when the identification of impacts take place or a later stage when assessing such impacts in step C.
96. Stakeholder engagement may equally corroborate the evidence that support financial materiality of sustainability matters. Users of the sustainability statement may play a role in helping companies assess financial materiality. The conclusions of the ESRS financial materiality assessment should be based on supportable evidence, which include views and interests of stakeholders. This is aligned with current practice for the financial reporting materiality processes, where notes to the financial statements and presentations to investors are adjusted regularly to reflect emerging issues and other matters of interest to investors. To this extent, the undertaking could leverage existing mechanisms of dialogue with shareholders, other investors, and lenders, to support its financial materiality assessment process.
97. In its approach to stakeholders' dialogue, the undertaking shall consider that stakeholders other than investors may also be interested in general-purpose sustainability-related financial information, as such information may be useful to assess how the undertaking manages its material impacts. For example:
 - 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).
98. In situations when consultation with stakeholders is not possible (for instance, because such engagements would put them at risk), the undertaking may consider appropriate alternatives such as consulting credible independent experts, for example (ESRS S3 *Affected communities*) an Non-Governmental Organisation (NGO) representing this affected community which can provide valuable feedback or, for environmental matters, scientific articles and reports.
99. ESRS 2 requires transparency on consultation conducted by the undertaking with affected stakeholders (Disclosure Requirement IRO-1, paragraph 53 (b) iii). This means that, even though ESRS do not mandate behaviour, the undertaking will be required to disclose engagement with stakeholders when identifying and assessing actual and potential negative impacts.
100. Chapter 5.4 *FAQ on stakeholder engagement* provides further guidance.

3.6 Deep dive on impact materiality - Setting thresholds for impact materiality

101. This section illustrates in more detail the methodologies or criteria that could be used for step C on impact materiality. ESRS 1 paragraph 42 states that an undertaking shall apply criteria set under ESRS 1 chapter 3.4 using appropriate quantitative and/or qualitative thresholds to assess the materiality of impacts connected to its activities, as well as those that are directly linked to its operations, products and services, including through the upstream and downstream value chain.
102. The severity of an actual or potential negative impact 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?

However, ESRS 1 does not prescribe how to set such thresholds.

103. ESRS 1 also states that the undertaking’s due diligence process informs the impact materiality assessment. In this context, the undertaking may use its ongoing due diligence process or other risk management processes to inform its thresholds setting and determine whether impacts are material for reporting purposes. In those processes, the undertaking’s management of adverse impacts is driven by an analysis of severity and/or risk prioritisation, which may inform the assessment of impact materiality.
104. When setting up the threshold, attention should be paid to any supportable evidence that provides as much objectivity as possible to the materiality conclusion. However, reasonable quantification of the potential impacts may not always be available to support the materiality assessment.
105. 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

106. In terms of applying the concepts described above and as an illustration, an undertaking could map its actual impacts to the three characteristics of severity in a columnar format (figure 4).

Figure 4: Graphical representation of impact severity for actual impacts (scale, scope, and irremediability) in columnar format

Negative impact	Severity assessment			Conclusion on materiality
	Scale	Scope	Irremediability	
Impact 1	Low	Medium	High	No
Impact 2	Low	High	High	Yes
Impact 3	Medium	Medium	Medium	Yes
...				
Impact N	High	Low	Medium	Yes

Colour coding:

Low	Medium	High
-----	--------	------

107. In terms of scale, this represents how grave is the impact for negative impacts and how beneficial the impact is or could be for positive impacts. Non-compliance with laws and regulations can be an indication of the scale; for example, if a negative impact leads to a violation of human rights. In this context, a reasonable objective measure to assess the various impacts may not be available (i.e., a quantitative measure); hence, the need to define thresholds (in some cases, qualitative ones).
108. In terms of scope, the measurement may vary depending on the sustainability matter in question. In some cases, the number of individuals affected could be the appropriate basis; for example, percent of employees or in other cases the number of countries /factories affected by such matter may be relevant. The scope factor could be assessed on a more quantitative basis than the other factors; and hence translating this value into a soft quantitative scale such as the colour coding or 1 to 5 scale mentioned above can be useful.
109. For positive impacts, the criteria are scale and scope and apply analogously.

3.6.2 Potential impacts

110. For potential impacts, the likelihood dimension is to be considered together with the severity of the impacts. However, in the case of human rights impacts, as specified in ESRS 1 paragraph 45, severity takes precedence over likelihood when identifying material matters.
111. 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.
112. 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).
113. 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) negative impacts are material for environmental matters; such decision is based on the judgement of the undertaking.

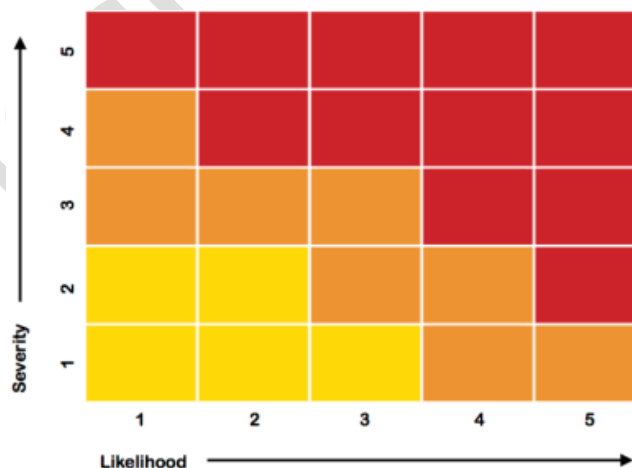
Example

A large 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.

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



3.7 Deep dive on financial materiality - Setting thresholds for financial materiality

114. ESRS do not describe how to define financial materiality thresholds. However, ESRS 1 paragraph AR 15 states in that respect: “Once the undertaking has identified its risks and opportunities, it shall determine which of them are material for reporting. This shall be based on a combination of (i) the likelihood of occurrence and (ii) the potential magnitude of financial effects determined in the basis of



appropriate thresholds. In this step it shall consider the contribution of those risks and opportunities to financial effects in the short-, medium- and long-term.”

115. The undertaking may refer to absolute monetary thresholds or to relative monetary thresholds, such as a percentage of the amount corresponding to a line item of its primary financial statements, its revenues, costs, total assets, net equity. Similar approaches are in practice used to assess materiality of an item for the preparation of financial statements and may be a possible source of inspiration. However, the undertaking shall consider that the time horizon for financial materiality assessment in sustainability reporting is longer than the typical time horizon factored in financial statements and management commentary. As an illustration, 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 lengthy period of time, to cover the long-term horizon.
116. In this context, the materiality assessment cannot be limited to the scope of financial effects that affect (or will affect in the future) items recognised in the financial statements. The undertaking shall as well consider financial effects associated with dependencies on natural and social resources that do not meet (or do not meet yet) the criteria for accounting recognition (ESRS 1 paragraph AR 14 and AR 15).
117. 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 narrative information may be material due to its nature, i.e., reflecting a qualitative approach to materiality.
118. 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, be financially material.
119. When the undertaking has in place mechanisms of dialogue with its shareholders, investors and lenders, it may corroborate the determination of its materiality threshold with input from their users' needs. This is because the goal of financial materiality is to report on information that, if omitted, misstated or obscured, could reasonably be expected to influence decisions that those stakeholders make on the basis of the undertaking's sustainability statement (ESRS 1 paragraph 48).
120. As in many cases sustainability matters that generate material impacts are also sources of material risks and opportunities, in its financial materiality assessment (refer to chapter 3 Step B and C), the undertaking shall carefully consider the linkages.

4. Materiality assessment – how to leverage other sources⁴?

4.1 Leveraging the GRI standards

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

⁴ The content of this chapter reflects the thinking of the EFRAG Secretariat and has not been validated by GRI nor by ISSB.

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

4.2 Leveraging the ISSB standards

123. In the intentions and expectations of EFRAG, as illustrated in the paragraphs below, the criteria for financial materiality and materiality of information in ESRS and the corresponding materiality approach in IFRS S1 are, in principle, aligned. The following paragraphs illustrate such alignment.
124. The financial materiality assessment in ESRS 1 corresponds to the identification of information that is considered material for primary users of general-purpose financial reports in making decisions relating to providing resources to the entity (ESRS 1 paragraph 48, aligned with IFRS S1 paragraph 1). The definition of financial materiality is aligned in the two standards⁵.
125. Reflecting the equivalence of the scope of financial materiality in the two frameworks, an undertaking that applies ESRS is expected to be able to comply with the identification of the risks and opportunities to be disclosed under IFRS using the outcome of its ESRS assessment of financial materiality. In other terms, the same financial materiality assessment process can support the identification of the risks and opportunities for both IFRS and ESRS purposes.
126. The general criterion for assessing the materiality of information and therefore to support the identification of the information to be reported on a material matter (ESRS 1 paragraph 31) is expected, in most cases, to rely on decision-usefulness (see chapter 2.3 *Criteria for the identification of material information*); this is also the criterion used in IFRS S1 to identify the information to be reported (as material). While in ESRS the double materiality assessment of what is decision-useful considers both investors and other stakeholders, in IFRS this is limited to the users' needs of investors. However, for the financial materiality component of ESRS, the two perspectives are expected to be equivalent.
127. Finally, IFRS S1 (paragraph 55) requires an entity to refer to and consider the applicability of the disclosure topics in the SASB Standards. Similarly, ESRS 1 (paragraph 131 b) identifies, as a source of disclosure that an undertaking may use in the definition of its entity-specific disclosures, the available frameworks or reporting standards, such as IFRS industry-based guidance (i.e., SASB Standards) and GRI Sector 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).

4.3 Leveraging international instruments of due diligence

128. The materiality assessment of an undertaking's impacts, risks and opportunities is informed by the outcome of its due diligence process, as defined in the international instruments of the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises.
129. 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

⁵ 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).

through its business relationships. This can be particularly useful when analysing the undertaking's upstream and downstream value chain and identifying the impacts originated there. Additionally, the due diligence instruments provide criteria to prioritise actions, based on the severity and likelihood of the impacts previously identified, for management.

130. 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.
131. Through this process the undertaking can also identify affected stakeholders, whose engagement informs the materiality assessment of impacts, risks and opportunities.

5 Frequently Asked Questions (FAQ)

5.1 FAQ on impact materiality

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

132. It is based on its impact to people or the environment, which are in turn stakeholders for the undertaking.
133. Impact materiality means the impacts on people and/or the environment connected with the undertaking's own operations and value chain, including through its products and services, as well as through its business relationships. It is assessed by reference to the severity of such impacts on the people and/or environment for actual or potential impacts. To assess such impacts stakeholder engagement is critical as described in FAQ 16 *Do ESRS mandate to actively engage with stakeholders?*
134. In contrast, financial materiality is focussed on the effects of sustainability matters on the undertaking's cash flows, financial performance, financial position, access to finance in the short-, medium- or long term or cost of capital, as such effects are material to the undertaking's investors.
135. In most cases material impacts are also associated with material risks and opportunities and, as a result, they are also 'material for the undertaking'. However, impact materiality is assessed based on severity for people and the environment, and not on the basis of the effects it has on the undertaking and its financial prospects.

FAQ 2: What is meant by the undertaking being "connected" with an impact?

136. 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.
137. The undertaking may be single-handedly responsible for the impacts, as the **impacts are directly caused** by its operations, products or services to people or the environment. For example:
- exposure of the undertaking's own workers to hazardous working conditions without adequate safety equipment in own operations;
 - being the sole source of pollution in a community's drinking water supply due to chemical effluents from production processes;
 - for a positive impact, an undertaking in the energy production sector adopting measures that lower the cost of renewable energy for customers, thereby allowing more customers to switch to renewable energy, and thus contributing to mitigating climate change.
138. **Impacts to which the undertaking has contributed** to are those not caused directly and solely by the undertaking's operations, products or services. When the impact is not caused solely by the undertaking but in conjunction with a third party: the undertaking's action or omission would not, single-handedly, cause the impact, but together with others' actions or omissions, it leads to the impact. For

example: several factories/sites in an area release harmful emissions into the air. Each release is below the harmful limit, but together they lead to the air being so polluted that a local community's air quality is affected.

139. When the undertaking facilitates or incentivises another party to cause or contribute to the impact. For example: changing buying requirements for suppliers repeatedly without adjusting production deadlines and prices, thus pushing suppliers to breach labour standards in order to deliver.
140. **Impacts directly linked to the undertaking's** operations, products, and services but caused by a business relationship. The entity that caused or contributed to the impact is linked to the undertaking. For example: The supplier subcontracting the embroidery on a retail undertaking's clothing products to child labourers in homes, counter to contractual obligations.
141. Distinguishing the type of involvement is important given that it could lead to a different assessment or categorisation of the negative impact.

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

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

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

143. No. Impacts are to be assessed on a gross basis. Positive impacts on the environment and people cannot be netted against negative impacts.
144. The following non exhaustive list of principles should be applied:
- different nature of impacts: an undertaking shall not net negative impacts with positive impacts of a different nature (in the reporting year or in future years) – this would contradict ESRS 1 paragraph 56: "... *The undertaking shall not aggregate material items that differ in nature.*" and the qualitative characteristics of quality (Appendix B of ESRS 1);
 - timing of impacts (current vs. future): an undertaking shall not net negative/positive impacts in the reporting year with positive/negative impacts of the same nature in future years; and,
 - location (in own operations vs. in the value chain): an undertaking shall not net negative/positive impacts in own operations with positive/negative impacts of the same nature in the value chain (in the reporting year or in future years).
145. 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, it should be noted that 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 FAQ on financial materiality

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

146. No, it is not the same. However, the objective remains the same.
147. The 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. ESRS 1 (paragraph 47) clarifies that the scope of financial materiality for the sustainability statement is an expansion of the scope of materiality used in the process of determining which information should be included in the undertaking's financial statements. This means that, whilst the concept of materiality does not differ between the two reporting frameworks. Its application on the information that is likely to be material does since the principles applied for the preparation of the financial statements, as illustrated by the financial reporting conceptual framework, establish a clear delineation of what should be accounted for on the basis of criteria for recognition of assets and liabilities (including in relation to control and/or obligations). 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.

148. The differences between information that is likely to be financially materiality for financial statements and management commentary and the information that is likely to be financially materiality for sustainability statement relate to the following aspects:
- a. sustainability reporting includes disclosures of potential financial effects of material risks or opportunities that are not captured or not yet fully captured by financial reporting at the reporting date and that could be reasonably expected to result in financial effects for the undertaking. Therefore, it is more likely that risks and opportunities that are yet to be 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;
 - b. the information on the parent and its subsidiaries is expanded in the sustainability statement to include information about material risks and opportunities arising from the undertaking's business relationships 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 become material for the sustainability 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 (for example, about anticipated financial effects) become material in sustainability statement;
 - d. time horizons may be looking at longer timeframes in sustainability reporting as they are not constrained by the financial planning horizon or by the historical cost convention.

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

149. No. As described in FAQ 5 *Is materiality for financial statements and management commentary the same as financial materiality for the sustainability statement?* the basis for preparation and time horizons of financial and sustainability reporting differs. The concept of current and anticipated financial effects defined in the glossary distinguishes between:
- a. financial effects that have already crystallised and are recognised in the primary financial statements or disclosed in the notes to 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).
150. Reporting certain financial effects associated with material sustainability matters in sustainability reporting goes beyond what is required to be recognised and measured in the primary financial statements and disclosed in the notes for those matters. In particular, financial effects that arise from risks and opportunities that 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 are to be reported irrespective of their accounting treatment. Sustainability risks or opportunities may derive from past or future events and may have financial effects in relation to:
- a. assets and liabilities already recognised in financial reporting. In this case potential adjustments to the carrying amount that are of interest for users of sustainability statement may not meet the accounting criteria for recognition in financial statements at the reporting date albeit these anticipated financial effects are recognised in sustainability statement
 - b. future assets, liabilities, income and expenses that are of interest to users of sustainability statement may have to be recognised in financial reporting at a later stage, when the accounting recognition criteria will be met; and
 - c. factors of value creation that do not meet the financial accounting definition of assets and liabilities and/or the related recognition criteria but contribute to the generation of cash flows and more generally to the development of the undertaking (for example, internally generated intangibles such as human capital that could be described in sustainability reporting).

5.3 FAQ on the materiality assessment process

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

151. The CSRD defines the frequency of sustainability reporting under ESRS which is annual as the sustainability statement forms part of the undertaking's management report. Accordingly, the undertaking is required to determine at each reporting date its material impacts, risks and opportunities, as well as the material information to be included in the sustainability statement.
152. However, if the undertaking concludes based on appropriate evidence that the outcome of the materiality assessment performed in the prior reporting period is confirmed also at the reporting date, the preparation of the sustainability statement may leverage the conclusions previously reached. This may be the case when, for example, the undertaking assesses that there have been no material changes in the organisational and operational structure of the undertaking and there have been no material changes in the external factors that could generate new, or modify existing impacts, risks and opportunities or that could impact the relevance of a specific disclosure. Examples of changed material facts and circumstances could be:
- a. a major M&A transaction leading to a new activity, entering a new sector or a significant change in operations;
 - b. a significant change of key suppliers or in the supply chain practices;
 - c. a global event such as a pandemic or entering 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 on a given matter significantly increases compared to previous periods; recent studies that 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. If so, the undertaking may limit the analysis to an annual update of its previous materiality 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).
153. The materiality assessment is a dynamic process that will be subject to the inherent evolution of the undertaking and needs to be updated on an ongoing basis.

FAQ 8: Is it sufficient to evaluate the list of sustainability matters of ESRS 1 paragraph AR 16 to identify material matters?

154. No.
155. 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 their own 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.
156. The list in ESRS paragraph AR 16 is a good starting point for the identification of sustainability matters, but it should not be applied as a checklist approach substituting a materiality assessment. It is an inventory of the sustainability matters covered in sector agnostic topical ESRS. Sector-specific⁶ and entity-specific sustainability matters (see ESRS 1 paragraph 11) should also be considered on top of this list.

⁶ Future sector specific ESRS will identify where appropriate additional sustainability matters.

157. 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?

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

159. In the steps of 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: in this step it is necessary to set an appropriate time horizon based on the context of the undertaking;
- b. for a proper **identification** of the list of sustainability matters: the undertaking needs to reflect over the entire time horizon (short/medium/long) to determine whether the impact, risk or opportunity may occur or not;
- c. for the **assessment** of material matters based on materiality of impacts, risks and opportunities: the undertaking may consider that the financial effects linked to material impacts may materialise on a different time horizon from the one of the impacts. In addition, when determining which of the impacts, risks and opportunities are material, thresholds and dependencies might be affected by the time horizon.

Example

The undertaking might for instance conclude that:

- a. the financial effect of assets currently used that could become stranded assets in the long-term due to environmental risks to be not material as they will be fully amortised at that future point in time;
- b. the financial effect of a risk likely to occur in the long-term to be not material due to discounting.

FAQ 70: Should the assessment of impacts, risks or opportunities rely on quantitative information?

160. Where possible, yes, as quantitative measures of impacts, risks and opportunities are the most objective evidence of how material they are.

161. The level of comfort sought by the undertaking from quantitative information also depends on scientific validated data and 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.

162. Quantitative information is not always available or may result in additional costs. Whenever a qualitative analysis is sufficient for the undertaking to reasonably conclude that a matter is "not material" or "material", adding quantitative information to the analysis would not bring much value to the materiality assessment. As mentioned above, the materiality assessment process evolves over time and the undertaking may be redefining the qualitative vs quantitative information balance.

163. Quantitative information would however be of interest where a topic is on the edge of the material/non-material border based on qualitative information and/or where there are many diverse

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:

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

views. In that case, quantification could be relevant to corroborate the conclusion. This could include impact valuation, which would also have the advantage to make different impacts comparable.

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

FAQ 81: Should the impact and risks and opportunities dimensions of a sustainability matter be aggregated for the materiality assessment?

165. No.

166. Despite that impact and financial materiality are inter-related and that the interconnections between the two dimensions shall be considered (see ESRS 1 chapter 3.3. Double materiality), a sustainability matter is not required to be material from both dimensions to be treated as material for reporting purposes.

167. 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 have not been considered financially material. Therefore, there is no aggregation of impacts and risks and opportunities on this matter.

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

168. ESRS do not prescribe a specific documentation, however it is reasonable to expect a certain level of documentation to be produced for internal purposes, such as to inform those in charge of the governance over the process of sustainability reporting (see ESRS 2 GOV- 5), in order to be able to prepare the disclosure prescribed by ESRS 1 IRO-1 and to allow assurance providers to perform their work.

169. The CSRD modifies the Accounting Directive with respect to the definition of the content of the management report in relation to sustainability information and its digitisation (namely Art 19a and Art 29a) and also has introduced mandatory assurance of the sustainability statement (in particular, Art 34).

170. The requirements with respect to the documentation and level of evidence supporting the materiality assessment (i.e., ESRS 2 IRO- 1 and 2 and ESRS SBM-3) is outside the remit of the ESRS.

FAQ 13: How to do the materiality assessment in diversified undertakings that operate across different sectors?

171. ESRS do not prescribe a specific process for the Materiality Assessment (MA). There is no one process for the materiality assessment that fits all undertakings, including diversified global undertakings.

172. A parent undertaking of a large group (according to CSRD art. 29a) has to disclose in its consolidated sustainability statement the group's impacts, risks and opportunities. For this purpose, the parent undertaking (as defined in ESRS 1 chapter 7.6) is to perform its materiality assessment for the consolidated group, irrespective of its group legal structure.

173. The parent undertaking may perform its materiality assessment using different approaches. As an illustration, two possible approaches could be:

- a. top-down approach, with an assessment at group level with engagement or consultation with the subsidiaries for specific matters; or
- b. bottom-up approach, involving the subsidiaries and consolidating the results.

174. In defining the thresholds (see step C in chapter 3.3), the parent undertaking of a large group which operates in different sectors, has to consider an appropriate level of consistency in scoring methodologies and in defining the thresholds (as defined in ESRS 1 chapter 3) across the entire group. An example of a trade-off that an undertaking may face is between a high severity impact from a small revenue stream and a medium severity impact from its main revenue stream; refer to chapter 3.7 deep dive on impact materiality for the criteria to be used.

175. As part of its initial assessment (see Step A in chapter 4.1), the undertaking can consider impacts, risks and opportunities (or alternatively subtopics) commonly associated with its sectors, geographic

locations, or with a specific subsidiary of the undertaking's organisation and define its perimeter. On this regard, the sector-standards will help identifying the impacts, risks and opportunities and subsequently assess 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?

176. Yes, this could be the case. The sector-specific standards represent another layer built upon the sector-agnostic standards and complement those in terms of depth for a given sub-sub-topic or can, when appropriate, add sub-sub-topics.
177. The intention is to achieve a consistent architecture between both sets of standards. The sector specific standards will provide a list and description of sustainability matters (namely at sub-sub-topic level) that are common in the sector and built upon ESRS 1 paragraph AR 16.
178. As a temporary measure whilst sector-specific standards have not been adopted, the undertaking shall make use of the Transitional provisions (see ESRS 1 chapter 10.1) related to entity-specific disclosures for material sector-specific matters not covered by a sector-agnostic standards or covered with insufficient granularity. This provision allows undertakings to carry forward sustainability information that it disclosed before adopting ESRS or design additional disclosures using best practice or other frameworks (e.g., IFRS industry-based guidance or GRI), when they prepare the entity-specific disclosure to be included in the sustainability statement following ESRS 1 paragraph 11. It is applicable for the first three sustainability statements of the undertaking.

5.4 FAQ on stakeholder engagement

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

179. ESRS require disclosure on the materiality process and its outcome but do not mandate specific behaviour on stakeholder engagement or the broader due diligence process.
180. However, ESRS 1 paragraph 45 states how 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, first, a tool that supports the undertaking's business processes as well as the management of sustainability matters. The undertaking in its preparation of the sustainability statement will be able to leverage the stakeholder's engagement put in place in the context of the due diligence process, if applicable.
181. Stakeholder engagement informs the identification and assessment of material impacts (see step A in chapter 3.1). It could be generally beneficial if the analysis of the undertaking's actual and potential impacts is mature and granular enough, to result in a meaningful level of engagement when assessing the impacts. This can help with the assessment of the scale and time horizons and also to ensure the completeness of the material impacts identified.

FAQ 16: Should all the categories of stakeholders be considered, or can the undertaking prioritise some of them for the materiality assessment process? On which basis?

182. 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, and this information is useful input to the materiality assessment.
183. ESRS 1 paragraph 22 (a) states: "affected stakeholders: the individuals or groups whose interests are affected or could be affected – positively or negatively – by the undertaking's activities and its direct and indirect business relationships across its value chain". The concept of key stakeholder (or relevant stakeholders in international instruments) rests on the idea that not all stakeholders will be affected by all activities of the organisation and the undertaking is to identify the stakeholders whose views are to be taken into account in connection with an activity. It also builds upon the basis that the degree of impact on stakeholders may inform the degree of engagement in terms of prioritisation.



184. The undertaking may consider having a dialogue with stakeholders or representatives to determine whether they are affected or not, if not obvious.

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

185. There might be stakeholders who cannot voice their concerns. For instance, nature has been identified as a silent stakeholder (see in ESRS 1 paragraph AR 7). Views of silent stakeholders should, however, be considered through the channels that are dedicated to monitor their concerns and therefore are able to provide valuable input to the materiality assessment.
186. Examples to illustrate how to consider silent stakeholders could be:
- Identifying the silent stakeholders that are likely to be impacted by the undertaking's activities, and consider the actual and potential impacts of the undertaking associated with each of them;
 - Conducting research to better understand the impacts that affect or could affect these stakeholders through reviewing scientific studies, articles, environmental impact assessments, and other relevant bibliographic documents;
 - Using proxies such as organisations that are legitimate representatives or are considered by the undertaking to appropriately represent the silent stakeholder. In case of nature, the undertaking may consider, for example, organisations that assess the current and future state of the ecosystem, water resources or climate; and
 - Testing the results of the estimated potential impacts based on experts' consultation, collaborative partnership with NGOs, and other stakeholders' engagement.

5.5 FAQ on aggregation / disaggregation

FAQ 18: Does the undertaking use the same level of disaggregation across all the impacts, risks and opportunities?

187. No. The disaggregation of reported information on material impacts should fairly reflect the severity of actual impacts or the severity and likelihood of potential impacts. For risks and opportunities, it should reflect the magnitude of current financial effects and the magnitude and likelihood of anticipated financial effects. In both dimensions, the principle to follow is to avoid obscuring the specificity and context necessary to interpret the information and to avoid aggregating material items that differ in nature as specified by ESRS 1 paragraph 54:

“When needed for a proper understanding of its material impacts, risks and opportunities, the undertaking shall disaggregate the reported information:

- 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 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 industry manufacturing 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 its workforce does pay below the adequate wages for the country and collective bargaining agreements do not take place, the materiality assessment should consider that level of disaggregation at country to identify material negative impact. 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 others.

188. Where the severity of impacts could be obscured by aggregating data, the undertaking should disaggregate per country, site, asset or subsidiary to meet the qualitative characteristics of information, namely relevance and faithful representation and, in this way, provide the most accurate and truthful representation when disclosing the severity of the related impact. The question of how data should be disaggregated should focus on the specific facts and circumstances of the undertaking where the actual or potential negative impacts occur. Hence, there are situations whereby the undertaking adopts a different level of disaggregation for two separate sustainability matters within the same topic (e.g., own workforce: adequate wages and training and development) and this would be appropriate.
189. For risks and opportunity, the focus is on whether the aggregation could obscure information that could have an influence on the investor's decisions to provide funds to the undertaking.
190. As described in ESRS 1 para 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?

191. In general no. The purpose of the disaggregation objectives for financial reporting and sustainability reporting is different (also refer to FAQ 5 "Is materiality for financial statements and management commentary the same as financial materiality for the sustainability statements?" 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)).

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.

192. Segment reporting under IFRS or local GAAP is based on a "management approach" (as defined in the IFRS) or based on another approach as the case might be for the segment reporting required under local GAAP. The criterion for financial reporting segmentation groups business activities or, in some cases, subsidiaries into segments that are as much as possible homogenous within the segment and non-homogenous as compared to the remaining segments. The level of disaggregation or reportable segments are consistently applied in the financial reporting without variation between the different reported items.
193. The disaggregation for financial reporting segments is designed for a different purpose and, in general, it is not appropriate to reflect the significant material impacts, risks and opportunities across the undertaking. The appropriate disaggregation unit may be a country, site, or significant asset when material impacts, risks and opportunities 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 impacts, risks and opportunities (see ESRS 1 paragraph 54).
194. Therefore, a disaggregation following the segments used for financial reporting may not be granular enough or relevant for sustainability reporting⁷.

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

5.6 FAQ on reporting

FAQ 20: Do ESRS require to disclose respectively severity, scale, scope, and irremediable character of material impacts, and likelihood of occurrence and potential magnitude of material risks and opportunities?

195. No. ESRS do not require to disclose the detailed outcome for each criterion, however an appropriate explanation of criteria and thresholds used is expected. The undertaking has to report on the processes to identify and assess material impacts, risks and opportunities as required by ESRS 2 IRO-1 and on the outcome as required by ESRS 2 SBM-3 and IRO-2. However, ESRS 2 SBM 3 Paragraph 48 (g) requires disclosure on changes to the material impacts, risks and opportunities since the prior year. For instance, the scale and irremediable character of a negative impact could have been assessed as high in the current period versus medium in the prior year and, hence, this negative impact became material and such information is to be disclosed.

196. As reported in FAQ 13 *Should the materiality assessment be documented/evidenced? And, if so, how?* ESRS do not prescribe a specific documentation, however it is reasonable to expect a certain level of documentation to be produced for internal purposes and for the auditors within the assurance engagement on the undertaking's sustainability statement.

197. Such documentation can also include a description of respectively severity, scale, scope, and irremediable character 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 auditor (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 financial (or impact) materiality?

198. The determination of information to be reported for metrics is informed by the assessment of material information to disclose (refer to chapter 2.3). Hence, information disclosed on metrics may be limited to information that is relevant either under the financial or impact materiality perspective and those datapoints that do not relate to the material impact or risk and opportunity are omitted⁸.

199. When a matter is assessed to be material from the financial (or impact) perspective only:

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

200. 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

⁸ A datapoint of a Disclosure Requirement in metrics may be omitted when the corresponding information is assessed to be not material provided that the omitted information is not needed to meet the objective of the Disclosure Requirement (ESRS 1 paragraph 34).

⁹ See ESRS 2 chapter 4.2 *Minimum Disclosure Requirements on policies and actions* and *Minimum Disclosure Requirements on targets* in chapter 5 *Metrics and targets*.

for stakeholders other than investors when a matter is material from the impact perspective, as it supports accountability.

FAQ 22: Is a group active in different sectors required to include data for the entire group in the metrics or only data for the entities/sectors of the group related to the material impact, risk or opportunity?

201. Once metrics have been assessed for materiality and the conclusion is that the metric is to be disclosed, the data for the entire group shall be included in the metrics; except for when specified differently in sector-agnostic topical or sector-specific standards (refer to the example below).
202. ESRS 1 stipulates that the sustainability statement shall be for the same reporting undertaking as the financial statements (ESRS 1 paragraph 62). If the undertaking prepares consolidated financial statements, the reporting entity is the entire group. For the assessment of material impacts, risks and opportunities, ESRS 1 clarifies that it is performed “for the entire consolidated group, regardless of its group legal structure” (ESRS 1 paragraph 102). The group legal structure is also irrelevant for reporting on metrics, as it cannot make a difference whether an undertaking is doing its business activities using multiple legal entities as a group or is organised doing the same business activities using only one legal entity.
203. However, ESRS 1 also stipulates that, “(w)hen a topical or sector-specific ESRS requires that a specific level of disaggregation is adopted in preparing a specific item of information, the requirements in the topical or sector-specific ESRS shall prevail” (ESRS 1 paragraph 57). Therefore, undertakings can disaggregate the metric information further rather than at group level.
204. Disclosure regarding impact, risk and opportunity management related to policies, actions and targets will reflect the extent of the activities within the group that are covered by those policies, actions and targets. As such, they may only cover the “problem area” of the material impact, risk and opportunity, when appropriate. Likewise for entity-specific metrics, the metric could be focussed on the parts of the group where such material impact, risk or opportunity arises.
205. In addition, ESRS 1 also stipulates for the level of disaggregation that “when needed for a proper understanding of its material impacts, risks and opportunities, the undertaking shall disaggregate the reported information ...” (ESRS 1 paragraph 54).

Example:

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

FAQ 23: When an undertaking has already put in place actions to avoid, minimise, mitigate or rehabilitate environmental impacts, shall it nevertheless report on the impacts before those actions? SUBJECT TO REDRAFTING

209. This will depend on the specific facts and circumstances of the undertaking as well as the negative impact. Two categories to be considered carefully, are:



- a. the time dimension that distinguishes between the period when the activity had not started and when it is ongoing; and
 - b. the likelihood of occurrence of uncertain events.
210. These categories give rise to four potential scenarios which are further illustrated below with the example of an undertaking's decision of building a chemical plant. In all scenarios, the undertaking shall disclose the material negative impact irrespective of the actions implemented to avoid, minimize, mitigate or rehabilitate it. Given that policies, actions and targets (or the lack of them) are to be disclosed for material impacts, the undertaking shall describe the actions taken according to the mitigation hierarchy and can provide information on the effects on the impact in terms of severity and likelihood.
211. **Stage 1 – impact assessment stage:** The undertaking is considering whether or not to build the chemical plant. The undertaking has made an impact assessment which identifies and assesses the impacts. Some of these impacts are permanent and other temporary and some impacts are certain and other uncertain. In this example, the impacts relate to the volume of pollutants emitted to water from a certain activity. The recommendations from the impact assessment are the use of a certain production technology (pollution prevention, a form of minimization) and the use of a wastewater treatment plant ('WWTP') (minimization) to achieve final emissions at the discharge point compliant with Best Available Technology reference levels.
212. Furthermore, the impact assessment has concluded that due to the volume of water which will be withdrawn from a local river and discharged back to it, there will be severe hydrological impacts. Hence, the undertaking should withdraw water downstream from where it discharges it, and it should implement special restoration measures in the river section between discharge and withdrawal.
213. At this point, the undertaking still has all four steps of the mitigation hierarchy available: 1) it can build the plant or not; 2) it can mitigate it by implementing BAT; 3) it can decide on which restoration measures to apply or not; and 4) it can decide on implementation of certain offsetting measures. From a reporting standpoint, if the (potential) impacts are considered material, the undertaking shall disclose both the (potential) unmitigated impacts, together with its mitigation measures (i.e., actions in ESRS language) and the expected final (potential) impact because of the actions planned or undertaken. If the undertaking decides not to advance with the project, the negative impacts described in this paragraph would not have taken place and no reporting would be performed.
214. **Stage 2 – impact mitigation stage:** The undertaking decided to advance with the project and has built the plant. This decision leads to a number of impacts, which the undertaking shall disclose from both a mitigated and unmitigated perspective. Specifically, during the first year of operations of the plant, the undertaking discloses both the potential impact of pollution in case that no WWTP exists or of its breakdown or malfunction; and its actual pollutant emissions to water after the WWTP. After that first year of plant operations, the undertaking shall only report on its emissions.
215. In this example, the undertaking also reports on the impacts caused by the construction of the chemical plant on the river in the first year; the effects of the increase of water pollutants at that cross-section of the river, any restoration measures being implemented and any offsetting measures it is taking. This phase is the start of the reporting on business-as-usual activities of the plant and when the undertaking is implementing its impact mitigation strategy – minimizing pollution, restoring ecosystems and offsetting where needed.
216. **Stage 3 – risk management stage:** This business-as-usual activity phase, the undertaking acknowledges that uncertain events may cause impacts. Through its risk management process, the undertaking has identified the following critical risks to its operations: a breakdown of its chemical storage tanks and leak of its chemical products into the local river; the accidental release of untreated wastewater; risk of flooding affecting its production facility. For the potential negative impacts assessed as material following the impact materiality criteria established in chapter 3 of this guidance, the undertaking shall report its unmitigated impacts, as well as mitigation measures in place (i.e., actions).
217. **Stage 4 – impact remediation stage:** In case one of the risks detailed in the paragraph above crystallises and become a material actual impact, the undertaking shall report the unmitigated impact in the year such accident occurs together with any actions taken (i.e., remediation efforts). In subsequent years, if the impact is still assessed as material, it shall report the impact together with its on-going remediation activities that minimises its effects and restoring the environment to its previous conditions.

218. To summarise the key considerations illustrated in the example above:
- Impact assessment stage: disclosure of unmitigated material impacts of projects and mitigation measures;
 - Impact mitigation stage: disclosure of material unmitigated material impacts in the first year of operations as well as material mitigated impacts; report only mitigated effects in the following years;
 - Risk management stage: report unmitigated material impacts (gross risk), as well as risk management actions in place;
 - Impact remediation: if risk materializes, report unmitigated impact in first year and on-going remediation efforts. In subsequent years, material mitigated impacts subsisting, as well as remediation activities.

FAQ 24: Shall the undertaking report also on material matters that have not been managed and/or for which there are no actions?

219. Yes. The materiality assessment is performed by the undertaking to identify the material impacts, risks and opportunities to be reported, which are classified into sustainability topics, sub-topics or sub-sub-topics (also referred as “matters”).

220. ESRS 1 paragraph 33 establishes that for the material impacts, risks or opportunities identified, the undertaking is to disclose its policies, actions and targets to manage those. And it specifies that if the undertaking has not implemented a policy, action or target, this fact is to be disclosed. The requirements of information to be disclosed for policies, actions and targets are detailed in ESRS 2 chapter 4.2 and 5.

Example

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

5.7 FAQ on Art. 8 EU Taxonomy

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

221. 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.
222. 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. This gives rise to three scenarios:
- a. If the activity complies with the criteria for substantial contribution, this indicates a reduced or even positive impact on the respective environmental objective;
 - b. If the activity does not comply with the substantial contribution criteria but the undertaking has a Capex plan to comply in future, this indicates a reduced negative or positive impact and may be a source of opportunity for the undertaking.
 - c. If the activity does not comply with the substantial contribution criteria and has no Capex plan to do so, this provides an indication of a negative impact on the respective environmental objective, and an associated risk.
223. When an undertaking with taxonomy eligible activities does not comply with one or more of the DNSH criteria, there is a strong indication that it has negative impacts on the respective environmental objective to which the non-compliant DNSH criteria relate, which may also translate into material risks for the undertaking. If the activity complies with the DNSH criteria, negative impacts may still occur and require consideration.

224. Activity-based Capex invested by the undertaking in the reporting year is also an indicator of its risks and opportunities, regardless of whether the activities are eligible from a revenue perspective. Disclosing the Capex plans, and how they fit within the undertaking's wider transition plan, which may lead to changes to the undertaking's strategy, business model or creation of a new revenue stream can be information that is considered material for primary users of general-purpose financial reports (i.e., investors of the undertaking).
225. As an example, an undertaking in the energy sector where its current activities are not covered by the taxonomy delegated acts. The undertaking could be investing in renewable energy as part of a Capex plan to provide renewable energy to its customers by creating a new revenue stream and such information could be financially material.
226. The undertaking is expected to consider this in its materiality assessment when identifying actual and potential impacts, risks and opportunities and related sustainability matters for the materiality assessment, refer to chapter 3.2 (step B) of this Guidance. Engaging in taxonomy eligible activities, for those undertakings under the scope of Art 8 Taxonomy, can trigger the need to apply the respective topical ESRS and report on the positive or negative environmental impacts and associated risks and opportunities. In turn, however, an undertaking cannot preclude that taxonomy alignment in terms of substantial contribution and complying with DNSH criteria implies that it has no actual or potential impacts or risks in relation to the respective environmental topics. Such triggers are inputs to the double materiality assessment that the undertaking has to perform.

Example of an undertaking constructing new buildings

227. An undertaking constructs new buildings which is a Taxonomy eligible activity. The substantial contribution criteria (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. Either way, the impact of the activity on the SC objective should be included in the list of potential impacts and the opportunity should be included in the list of potential material opportunities in the materiality assessment for ESRS E1.
228. 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. The activity therefore has an actual negative impact on biodiversity. This impact should be included in the list of potential impacts in the materiality assessment for ESRS E4.

Example of a manufacturer of electrical equipment

229. An undertaking manufactures high, medium, and low voltage electrical equipment for electrical transmission and distribution, which is a Taxonomy eligible activity. As an enabling activity, the SC criteria for the Climate Change Mitigation (CCM) 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. The undertaking needs to conduct its materiality assessment.
230. 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, that has to be included in the list of potential impacts in the materiality assessment of ESRS E2.

