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Issue paper

Materiality approach to Sector ESRS

Objective of this paper

In the context of the strategic direction to be provided by EFRAG SRB to EFRAG SR TEG to progress on the drafting on sector ESRS, a key step is the decision on the materiality approach to be adopted in the sector ESRS. This paper presents a technical analysis of how the approach to materiality in the Set 1 Delegated Act (sector agnostic) and the sector standard materiality approach work together and assess issues that emerge from their interaction.

Background – previous SRB discussions

(The SoDs for the SRB meetings of 14 March 2023 and 13 September 2023 are available on sharefile.)

The EFRAG SRB discussed on 13 September 2023 the materiality approach for sector standards, considering the changes in the materiality approach from the November 2022 draft ESRS to the Delegated Act (DA)¹².

The paper provided for that meeting illustrated the two approaches to sector materiality that achieved consensus in EFRAG SR TEG and the EFRAG SRB respectively in March 2023 (identified in this paper as TEG Consensus and SRB Consensus), plus the approach adopted by the EC in finalising the DA (DA approach). The first two are sector-specific materiality approaches, while the DA is focused on a sector-agnostic approach. The table below summarises the essential features of those three approaches. The TEG Consensus is indicative, as superseded in March 2023 by the SRB Consensus.

¹ <https://efrag.sharepoint.com/Meetings/2302241024321451/Meeting%20Documents/06-01%20Sector%20materiality%20EFRAG%20SRB%20230913.pdf>

² Annex 1 compares the sector agnostic materiality provisions in the draft standards released by EFRAG in November 2022 with the DA. The differences pertain to ESRS E1, specific ESRS S1 Own workforce data points, the voluntary nature of the explanations when a matter is omitted, and the transparency for non-EU data points.



Approach	TEG Consensus	SRB Consensus	DA approach
List of sustainability matters (SM) included in the sector standard	Outside materiality approach (assumed to be always material).	Subject to materiality assessment.	
Transparency about omitted matters	NA (material matters cannot be omitted)	Disclosure of MA conclusions to be sufficiently detailed to understand why sectorial sustainability matters (topic level or, if relevant, sub-topic level or sub-sub-topic level) are not material (i.e., how business model/ location/ products interact with each of the non-material matters).	Detailed explanation when climate change (topic level) is not material. For all other topic sustainability matters, “may” data point to conclusions of materiality assessment for that topic.
Transparency about omitted DR or datapoints of material sustainability matters	Explanation when a DR is omitted. No explanation when a data point is omitted.	Omitting DRs for PAT not possible unless no PAT adopted (in which case disclosure to be the case and “may” disclosure on timeframe for adoption). Omitting DRs for metrics defined at sector level is possible with no further explanations. However, need for ARs clarifying conditions as to why not material (see below under other aspects). Omitting datapoints for metrics defined at sector level is possible (following paragraph 34 of draft ESRS 1) with no further explanations. However, in addition, paragraph 39 of draft ESRS 1: when metric DRs or datapoints are omitted, they are considered implicitly “not material”.	Omitting DRs for PAT not possible unless no PAT adopted (in which case disclosure to be the case and “may” disclosure on timeframe for adoption). This is applicable at topical <u>and</u> sector-agnostic level. Omitting DRs or datapoints for metrics defined at topical level is possible (under paragraphs 34 of ESRS 1) with no further explanations. However (under paragraph 35 of ESRS 1): for other EU legislation datapoints omitted, need to state that they are “not material” (NB: most if not all metrics datapoints required by topical sector-agnostic ESRS are related to other EU legislation). No specific indication regarding implicit “not material”.
Other aspects	In order to identify DRs to be always mandatory at sector level, consult on them ³ .	New application requirements to clarify when a DR on a material SM can and cannot be omitted. ⁴	NA

³ EFRAG SR TEG approved the ED OG and MQC on 6 and 7 March. As an integral part of SR TEG advice to SRB, the EFRAG recommended to consult on whether some of the DRs in the sector ESRS should be outside materiality and which they should be.

⁴ For example, omitting DRs related to impacts on indigenous community would be only possible when the company does not have operations nor contact with such community. Appropriate DRs to be drafted reflecting the content of the specific DRs.



Discussion

Based on the comparison in this table, focusing on the SRB Consensus and DA approach, the difference is on transparency:

- about the conclusions of the materiality assessment when a sustainability matter is not material;
- about omissions of DRs; and
- about omissions of datapoints.

The EFRAG Secretariat notes that in terms of the standard-setting process, there is a progressive level of specification on sustainability matters (from topic to sub-topic and sub-sub-topic⁵) and on the corresponding DRs when moving from sector-agnostic to sector-specific standards. The sector-agnostic ESRS (DA approach) reflects SMs and DRs that are expected to be relevant for an 'average undertaking', irrespective of its sector classification. In contrast, sector-specific ESRS leverages a specification of SMs and DRs, relevant to the 'average undertaking' that operates in the specified sector. This specificity enhances the relevance of the SM and DRs in sector-specific standards as compared to the sector-agnostic ESRS. Enhanced transparency on the conclusions of the materiality assessment when a sector SM or DR is not material is a useful information in the context of sector standards.

For this reason, the EFRAG Secretariat indicated in the paper for SRB 13 September 2023 its preference for the SRB approach, as this would allow to reflect more closely the specificities of sectors and result in a more robust standard setting and more transparent and relevant reporting.

The EFRAG Secretariat understands that the paper presented in September 2023 created a perception that having a sector materiality approach consistent with the one adopted at sector-agnostic level in the DA would be an advantage. According to some SRB members, this element risks distorting the conclusions toward adopting the DA approach as the approach to adopt also at the sector level. This was not the intention of the 13 September paper.

Some EFRAG SRB members also noted that the SRB 2023 approach was consistent with the approach taken by the DA for ESRS E1 *Climate change*.

Some members disagreed with the SRB approach, as it would deviate from the DA approach, and this would confuse preparers.

In contrast, others noted that the ESRS Architecture envisages (three) separate layers (agnostic and sectorial + entity-specific) from inception. They also considered that a more granular materiality approach (based on sub-topical or sub-sub-topical levels) compared to the DA approach (based on topic level) is necessary as it provides more relevant reporting at sector level.

⁵ In the rest of this paper, we make a distinction between topic and sub-topic levels of sustainability matters. When mentioning sub-topic levels, we also refer to sub-sub-topic, unless explicitly mentioned.



The developments below examine the impacts on the transparency required under the SRB approach as compared to the DA approach.

1. Regarding the transparency on materiality of sustainability matters:

As illustrated in the table above, the SRB approach in substance results in adding one datapoint (justification of why a SM -sub-topic or sub-sub-topic level- relevant for the sector is not material) that is not required (except for climate) in the DA (where this datapoint is a “may”).

The EFRAG Secretariat considers this addition justified, as the SRB approach allows for reflection of the specificities of the sector requirements and the higher-level commonality in the results of the materiality assessment.

The EFRAG Secretariat notes that in the CSRD, Article 29(b)(1) states that the delegated act that will follow the sector agnostic ESRS shall specify information that undertakings are to report that is specific to the sector in which they operate. Article 29(b)(1) further states that particular attention shall be paid to the scale of the risks and impacts related to sustainability matters for each sector, taking account of the fact that risks and impacts are higher for some sectors than for others.

The EFRAG Secretariat notes that the addition of a specific datapoint is compatible with the logic envisaged in the CSRD of adding “information that is specific to the sector in which they operate”. The EFRAG Secretariat does not consider the SRB approach (which turns a “may explain” datapoint of the DA into a “shall explain”) as conflicting or contradicting the DA. On the contrary, it responds to the logic of setting additional information requirements that are specific to the sector.

2. Regarding the transparency on materiality of DRs:

As also illustrated in the table above, the SRB approach and the DA approach are similar with respect to PAT. For Metrics, the SRB approach is also similar but introduces ARs to clarify the conditions under which DRs can or cannot be omitted.

The EFRAG Secretariat considers that the addition of ARs is a useful tool to ensure that the materiality assessment is performed under robust principles.

3. Regarding the transparency on materiality of datapoints:

The DA approach introduces an element of transparency with respect to metrics deriving from other EU legislation which was not contemplated under the SRB approach for sector-specific standards (and in the November 2022 Technical Advice). If at sector-agnostic level there seems to be an overlap between required ESRS metrics and the ones deriving from other EU legislation, it might not be the case at sector-specific level or it may vary from one sector to the other. Therefore, it is not suggested to consider this element of transparency at sector-specific level on a systematic basis. When developing draft standards, it could be considered on a case by case basis depending upon the regulatory environment of each sector.

The implicit statement that omitted datapoints are “not material” is suggested as an AR as it reinforces the expected level of comprehensiveness of the materiality assessment in the absence of transparency at datapoint level.



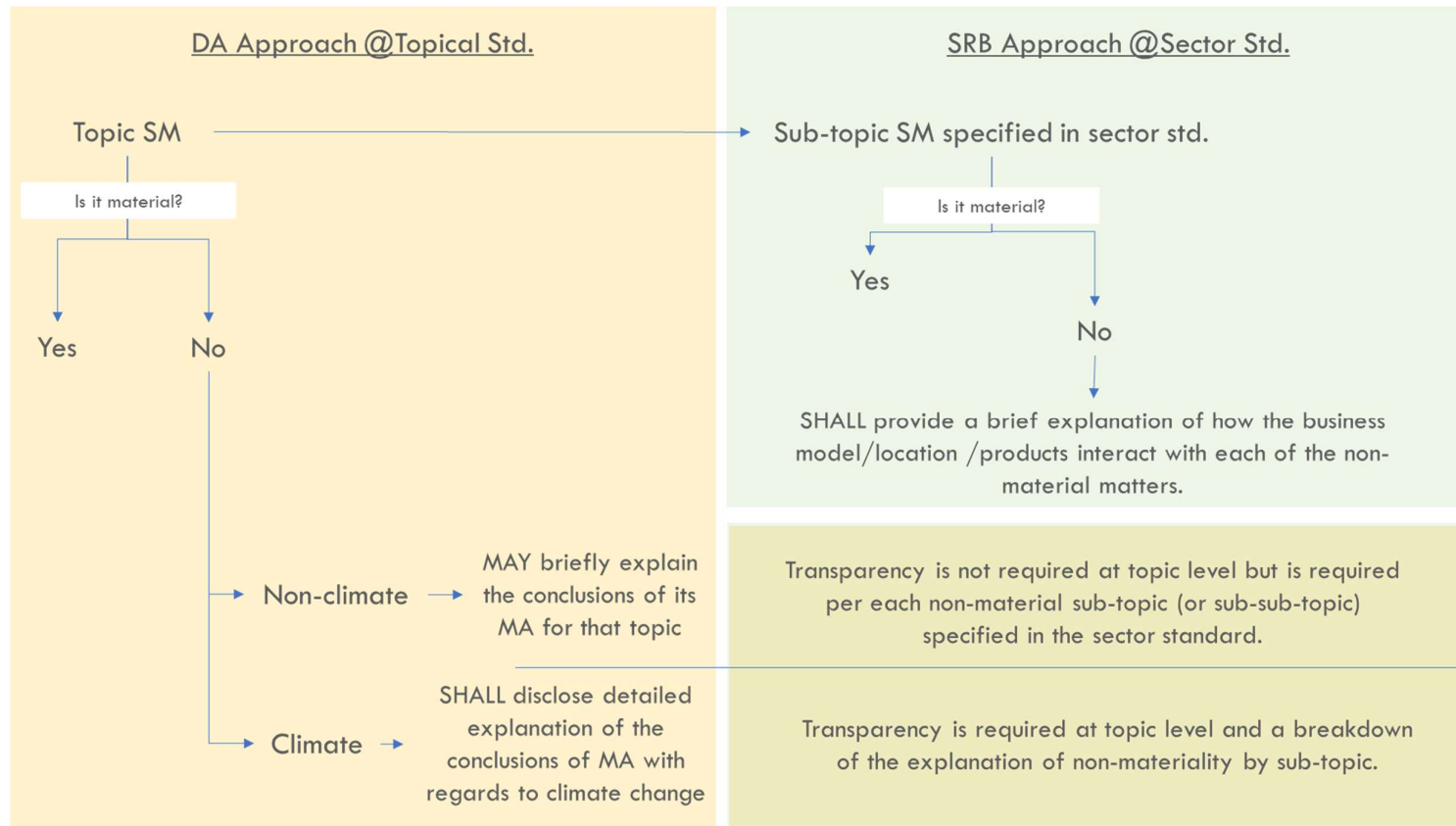
Appendix 1 – Differences in the materiality provision at sector agnostic level between EFRAG draft standards (November 2022) and the Delegated Acts

In red are highlighted items where there is a difference.

November 2022 Advice	Delegated Act
<i>ESRS 2 outside materiality</i>	
Climate outside materiality	'shall' include explanation on conclusion that Climate is not material
S1-1/S1-9 outside materiality for companies above 250	No special treatment of S1-1/S1-9
<i>Other matters listed in AR 16 in materiality scope</i>	
'shall' include a brief explanation when a topic is omitted	'may' include a brief explanation when a topic is omitted
<i>DR and datapoint of Metrics for a material matter are omitted if not material</i>	
Omitted DR and datapoints of Metrics are considered to be implicitly reported as 'not material'	When datapoints of Metrics that derive from EU legislation are omitted, 'shall' disclose that they are 'not material'
<i>Positive list of DRs included (no list of omissions)</i>	



Appendix 2 - Level of transparency required in the interaction of DA approach and SRB approach for sector standards



Appendix 3 – Comparison with sector materiality approach in GRI

GRI Materiality – General approach and Sector Standards

This section's purpose is to perform a comparative analysis between the GRI materiality approach on sector standards versus the EFRAG proposal in this paper.

Background

GRI Universal Standards defines the architecture of the GRI Standards and introduces the role of GRI Sector Standards. Given that GRI has issued several sector standards, but these do not cover all the sectors; there are currently two starting points for GRI companies to follow when it comes to performing the impact materiality assessment and disclosing the conclusions reached. On the one hand, the Universal Standards general approach is to be followed by companies who are not subject to sector standards yet as these have not been issued. On the other hand, the Universal Standards sector approach for companies whose applicable sector standards have been issued. For this analysis, the focus will be on the GRI sector approach.

GRI sector approach – System and materiality

GRI 1 defines the system and role of GRI sector Standards when performing the impact materiality assessment. GRI 1.3 states that the: *“The Sector Standards provide information for organizations about their likely material topics. The organization uses the Sector Standards that apply to its sectors when determining its material topics, and when determining what information to report for the material topics”*.

This is consistent with GRI’s sector architecture whereby the sector standards satisfy two objectives: i) identification of a subset of likely material topics and related disclosures that emanate from the closed list of topics defined by the GRI Topic standards and ii) addition of a few recommended disclosures (i.e. disclosures or recommendations) that built upon the GRI Topic standards disclosures.

The impact materiality assessment process for the GRI general approach and GRI sector approach is the same. However, the level of transparency of the outcome of the impact materiality assessment process differs.

Transparency on the materiality assessment results

Topic level

The company applying the GRI sector approach starts the materiality assessment with the likely material topics described in the relevant sector approach (refer to GRI 3, Step 4 Box 5). The outcome of this process disclosed according to GRI 1 Requirement 3 – Determine material topics. Such outcome is binary for each likely material topic, and it is to be disclosed as follows:

- The topic is material. The company will include the material topic in the GRI Content index; or
- The topic is not material. The company explains why the topic is not material.

Therefore, this GRI sector approach is aligned with the EFRAG's proposal laid out in this paper.

Disclosure Requirement level

Once a topic is material, the company is to report the related disclosures. However, the company can omit the disclosure of a material topic by reporting it as "not applicable" and providing an explanation in the GRI content index.

Therefore, there is a difference in approach between EFRAG's proposal and GRI. EFRAG's current proposal does not require an explanation for omitting disclosures.

Appendix 4 – Relevant ESRS paragraphs

ESRS 1

29. Irrespective of the outcome of its materiality assessment, the undertaking shall always disclose the information required by: ESRS 2 General Disclosures (i.e. all the Disclosure Requirements and data points specified in ESRS 2) and the Disclosure Requirements (including their datapoints) in topical ESRS related to the Disclosure Requirement IRO-1 Description of the process to identify and assess material impacts, risks and opportunities, as listed in ESRS 2 Appendix C Disclosure/Application Requirements in topical ESRS that are applicable jointly with ESRS 2 General Disclosures.

30. When the undertaking concludes that a sustainability matter is material as a result of its materiality assessment, on which ESRS 2 IRO-1, IRO-2 and SBM-3 set disclosure requirements, it shall:

- (a) disclose information according to the Disclosure Requirements (including Application Requirements) related to that specific sustainability matter in the corresponding topical and sector-specific ESRS; and
- (b) disclose additional entity-specific disclosures (see paragraph 11 and AR 1 to AR 5 of this Standard) when the material sustainability matter is not covered by an ESRS or is covered with insufficient granularity.

31. The applicable information prescribed within a Disclosure Requirement, including its datapoints, or an entity-specific disclosure, shall be disclosed when the undertaking assesses, as part of its assessment of material information, that the information is relevant from one or more of the following perspectives:

- (a) the significance of the information in relation to the matter it purports to depict or explain; or
- (b) the capacity of such information to meet the users' decision-making needs, including the needs of primary users of general-purpose financial reporting described in paragraph 48 and/or the needs of users whose principal interest is in information about the undertaking's impacts.

32. If the undertaking concludes that climate change is not material and therefore omits all disclosure requirements in ESRS E1 Climate change, it shall disclose a detailed explanation of the conclusions of its materiality assessment with regard to climate change (see ESRS 2 IRO-2 Disclosure Requirements in ESRS covered by the undertaking's sustainability statement), including a forward-looking analysis of the conditions that could lead the undertaking to conclude that climate change is material in the future. If the undertaking concludes that a topic other than climate change is not material and therefore it omits all the Disclosure Requirements in the corresponding topical ESRS, it may briefly explain the conclusions of its materiality assessment for that topic.

33. When disclosing information on policies, actions and targets in relation to a sustainability matter that has been assessed to be material, the undertaking shall include the information prescribed by all the Disclosure Requirements and datapoints in the topical and sector-specific ESRS related to that matter and in the corresponding Minimum Disclosure Requirement on policies, actions, and targets required under ESRS 2. If the undertaking cannot disclose the information prescribed by either the Disclosure Requirements and datapoints in the topical or sector-specific ESRS, or the Minimum Disclosure Requirements in ESRS 2 on policies, actions and

targets, because it has not adopted the respective policies, implemented the respective actions or set the respective targets, it shall disclose this to be the case and it may report a timeframe in which it aims to have these in place.

34. When disclosing information on metrics for a material sustainability matter according to the Metrics and Targets section of the relevant topical ESRS, the undertaking:

(a) shall include the information prescribed by a Disclosure Requirement if it assesses such information to be material; and

(b) may omit the information prescribed by a datapoint of a Disclosure Requirement if it assesses such information to be not material and concludes that such information is not needed to meet the objective of the Disclosure Requirement.

35. If the undertaking omits the information prescribed by a datapoint that derives from other EU legislation listed in Appendix B of ESRS 2, it shall explicitly state that the information in question is “not material”.

ESRS 2 – IRO 2

55. The objective of this Disclosure Requirement is to provide an understanding of the Disclosure Requirements included in the undertaking’s sustainability statement and of the topics that have been omitted as not material, as a result of the materiality assessment.

56. The undertaking shall include a list of the Disclosure Requirements complied with in preparing the sustainability statement, following the outcome of the materiality assessment (see ESRS 1 chapter 3), including the page numbers and/or paragraphs where the related disclosures are located in the sustainability statement. This may be presented as a content index. The undertaking shall also include a table of all the datapoints that derive from other EU legislation as listed in Appendix B of this standard, indicating where they can be found in the sustainability statement and including those that the undertaking has assessed as not material, in which case the undertaking shall indicate “Not material” in the table in accordance with ESRS 1 paragraph 35.

57. If the undertaking concludes that climate change is not material and therefore omits all disclosure requirements in ESRS E1 Climate change, it shall disclose a detailed explanation of the conclusions of its materiality assessment with regard to climate change (see ESRS 2 IRO-2 Disclosure Requirements in ESRS covered by the undertaking’s sustainability statement), including a forward-looking analysis of the conditions that could lead the undertaking to conclude that climate change is material in the future.

58. If the undertaking concludes that a topic other than climate change is not material and therefore omits all the Disclosure Requirements in the corresponding topical ESRS, it may provide a brief explanation of the conclusions of its materiality assessment for that topic.