

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG SRB. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG SRB or EFRAG SR TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG SRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

# Materiality approach for ESRS sector standards

## Cover Note

### Objective

1. Objective of this paper is to support a discussion on ways forward for the approach on materiality for sector standards, in consideration of the changes in the materiality approach from the November 2022 ESRS drafts to the Delegated Act (DA).
2. This is not a decision-making session, so no votes are expected at this stage. However, the EFRAG Secretariat would welcome to know the initial orientations of the SRB members.
3. For that purpose, a brief review of what has been discussed and agreed to date is presented, followed by proposals by the secretariat for discussion.
4. This paper focuses on two approaches: the materiality approach in the Delegated Act (ESRS Set 1) - identified as 'Approach C' - and the approach that was agreed by the SRB on a consensus basis in the SRB meeting of the 14 March 2023 – identified as 'Approach B+'.

### Approach C – Materiality in the DA

5. The approach to materiality of matters and information materiality at sector agnostic level can be summarised as follows:
  - a. all datapoints in ESRS 2 are outside the materiality assessment;
  - b. the sustainability matters in AR 16 are not presumed to be always material nor likely to be material, but they are subject to (and to be used as a reference in) the materiality assessment;
  - c. an explanation of the conclusions of the materiality assessment is required only for climate change and is optional for the other topics. For the other topics the undertaking may include an explanation on a voluntary basis;
  - d. for policies, actions and targets (PAT), when a matter is material, all the datapoints in topical or sector specific ESRS and the minimum disclosure contents in ESRS 2 are to be reported, with a level of granularity in the narrative disclosure that is to be defined by the undertaking, reflecting the principles in ESRS 1 paragraph 31. Minimum disclosure requirements are also to be applied when the undertaking includes PAT entity-specific disclosures on a sustainability matter. When an undertaking does not have in place PAT it shall disclose this to be the case and it may report a timetable for the introduction of such PAT;
  - e. for the metrics required by a topical (or sector ESRS) on a matter that has been assessed to be material, the undertaking shall include the DRs when the information required by those DRs is assessed to be material. When the information required by a given DR is assessed to be material, the undertaking may omit a datapoint of that DR if the



- information required by the datapoint is not material, provided that such information is not needed to meet the objective of the DR;
- f. for datapoints (PAT and metrics) required by a topical (or sector ESRS) that derive from EU law, a specific table is to be disclosed, detailing where in the sustainability statement the EU datapoint can be found (page/paragraph) and when an EU datapoint is omitted, as it has been assessed to be not material, the table shall report that that datapoint is assessed to be not material;
  - g. no list of omitted datapoints/DRs/standards is required, other than the table for datapoints deriving from EU law. A positive list of the DRs disclosed is provided.
6. The paragraphs that set the materiality approach in the DA (ESRS 1 and 2) are provided in Appendix 1 to this paper.

## Summary of the EFRAG discussions in March 2023

7. Following a number of meetings at SR TEG and SRB level, the EFRAG Secretariat presented two approaches to support the EFRAG SRB tentative decision making on materiality for sector ESRS on 14 March 2023.
8. Two approaches were considered:
  - a. Approach A (SR TEG consensus):
    - I. To include a list of material Sustainability Matters (SM) provided in the sector ESRS, to be considered by the undertaking as a basis for reporting. The SM are outside of the Materiality Assessment (MA) (so, these SM are considered material by default);
    - II. The MA would still play a role as it can lead to omission of Disclosure Requirements (DR) for Metrics, which could be omitted entirely or at the datapoint level – using the same approach as for ESRS Set 1 paragraph 34. When a DR on metrics is omitted for a material matter, the undertaking shall explain why the information required by that DR is not material. No explanation is required when a datapoint of a material DR is omitted;
    - III. Datapoints in PAT on a material matter cannot be omitted and if the undertaking does not have PAT for a material matter it simply states this to be the case and may report a plan for adopting PAT, as for ESRS Set 1 paragraph 33.
  - b. Approach B (SRB tentative consensus reached in the meeting on 27 February 2023):
    - i. To include a list of SM which should form part of the MA, but not presumed material;
    - ii. To require that a brief explanation shall be given as part of the MA disclosure for the exclusion of the SM and that it should be sufficiently detailed to understand what is material and what is not;
    - iii. Approaches to PAT and metrics are the same as in Set 1 ESRS (paragraphs 33 and 34).
9. One of the reasons to favour approach B is the similarity with the GRI approach at sector level (See Appendix 2 of this paper).
10. In the meeting on 14 March the SRB reached a tentative consensus on Approach B (subject to reviewing the revised draft of the Sector ESRS ED working paper), including clarifications on the level of transparency required about the conclusions of the MA. We identify this consensus as **Approach B+**, which is the same as B, plus the following specifications:
  - a. New ARs needed to clarify how the MA would work when omitting a DR on a material SM, i.e. when a DR can be omitted (e.g. to omit DRs related to impacts on indigenous



community, possible only when the company does not have operations nor contact with such community)<sup>1</sup>. Test this concept for DR on biodiversity metrics and resettlement caused or contributed to by the undertaking;

- b. The text in the sector ESRS describing materiality of SM should be the following: “*This [draft] ESRS identifies a list of matters commonly applicable to the undertakings operating in the Sector. This list shall be taken into account by the undertaking when performing its materiality assessment. In addition to the information required by ESRS 2- IRO 2, the undertaking shall provide the conclusions of its materiality assessment regarding the list of sustainability matters defined by paragraph XXX of this ESRS, with a brief explanation, in relation to its specific facts and circumstances, including the description of its business model, its locations and/or its products, of which matters are assessed to be material and which are no*”;
- c. 17 members participated to the vote and two of them could accept approach B as expressed in the wording above, if supported by clear application requirements and where the ‘brief explanation’ is expected to allow an understanding of how the business model/location/products interact with each of the non-material matters. One SRB member supported instead approach A. No abstentions.

## Possible options

11. Taking into account the SRB position of the materiality approach as per the tentative consensus reached on 14 March 2023 and the evolution of the materiality approach in the Delegated Act issued by the EC in the sector agnostic standards, the EFRAG Secretariat considers that **there are two possible approaches: Approach C and Approach B+, as described above**. We compare them below, focusing on the differences between the two.

<b>Approach</b>	<b>Advantages</b>	<b>Disadvantages</b>
Approach B+	It leverages the closer specification of SM that exists at sector level compared to sector agnostic level.	Not consistent with Set 1 ESRS.
Approach C	Consistent with Set 1 ESRS.	It doesn't allow to leverage the closer specification of SM that exists at sector level compared to sector agnostic level.

12. Approach C is similar to the approach adopted in the Delegated Act of 31st of July for the topical standards (other than climate). The company should assess the materiality of the SMs and, if considering them as non-material, an explanation for the omission of a SM within the sustainability statement is optional (« may » requirement).
13. Approach B+ is the one previously agreed by the SR Board and reinforces the centrality of the MA but also gives the necessary prominence to sector standards, which define a list of SM that (in this case) need to be assessed by the undertakings in their MA process and, if found not-material, briefly explained. The explanation is given per sustainability matter. This approach is somehow similar to the approach taken for the Climate standard in the Delegated Act of 31st of July, but more granular (not at level of topic, but at SM level).
14. Approach B+ requires a brief explanation as part of the MA disclosure (IRO 1) of specific sustainability matters identified at the level of sector standards. This means that Approach B will be different from the provision of §32 of ESRS 1 because, even if an explanation at topical

<sup>1</sup> Please note that these additional ARs would also be included in Approach C.

level is not required by ESRS 1, a brief explanation at SM level would be required by the respective sector standard.

15. On the contrary, approach C makes it optional to present a justification for the entire topic and does not specify where in the sustainability statement it should be included, prescribing only that it may be included, and is fully aligned with §32. This means that approach C treats the SM and DR in the sector ESRS in the same way as those in sector agnostic ESRS, therefore not allowing to leverage at sector ESRS an enhanced transparency on the MA. Such more enhanced transparency would allow to reflect the higher level of specificity of the sector ESRS compared to the sector agnostic requirements.
16. Coming back to approach B+ and its disadvantage of being different from the sector agnostic MA treatment, the extent of the difference would vary across sectors. In the high-impact sectors it is likely that most SM in ESRS 1 paragraph AR 16 are relevant and it may happen that sub-sub topics, that are not relevant at sector agnostic level but become relevant at sector-specific level, are added to the list of relevant SM for the sector. On the contrary, in lower-impact sectors it may happen that a number of SM in ESRS 1 paragraph AR 16 are not included in the sector ESRS list, as not relevant for the sector.
17. The EFRAG Secretariat has an initial preference for approach B+, as it would allow to reflect more closely the specificities of the sector ESRS requirements and, in this way, result in more robust standard setting and more transparent reporting.
18. The EFRAG Secretariat considers that in terms of standard setting process, there is a progressive level of specification of the SM and corresponding DRs when moving from sector agnostic to sector-specific standards. While sector-agnostic ESRS reflect in their content relatively broad SM and DR that are expected to be relevant for an ‘average undertaking’ irrespective of its sectors of activities, sector specific ESRS leverage a closer specification of SM and DR, as they include SM and DR that are relevant to the ‘average undertaking’ that operates in that sector. This allows to enhance the level of relevance of the SM and DR as compared to the sector-agnostic ESRS, as the requirements in the sector specific ESRS leverage a higher level of specificity.
19. The EFRAG Secretariat acknowledges that approach B+ has the disadvantage of resulting in a difference with the sector agnostic MA approach for SM that are common to sector agnostic ESRS and sector specific ESRS. However, the EFRAG Secretariat considers that this is justified by the benefits, as approach B+ allows to properly reflect the specificities of the sector requirements and the higher level of expected commonality in the results of the MA.
20. The EFRAG Secretariat considers that it would be beneficial to discuss the two approaches with the SR TEG, before the EFRAG SRB concludes.
21. Independently of the approach taken, as agreed by the SRB and SR TEG in its meeting of the 4th of April 2023, a question would be included in the public consultation questionnaire, in a section on “Sector standards principles and architecture design”, in respect of the materiality approach followed and its implications.

**Questions to EFRAG SRB**

22. This is not a decision-making session. However, the EFRAG Secretariat would welcome to know whether individual SRB members prefer approach B+ or approach C.
23. Do you consider that there are other approaches that should be considered at this stage?
24. Do you agree to collect EFRAG SR TEG advice before the SRB concludes on this topic?
25. Do you have any other comment on this paper?



26. Do you have any recommendation for the EFRAG Secretariat in terms of way forward?



## Appendix 1: Extracts from ESRS 1 and 2 on materiality

1. This appendix contains extracts from the delegated act related to materiality.
2. A sustainability matter is “material” when it meets the criteria defined for impact materiality or financial materiality, or both (ESRS 1 Paragraph 28).
3. 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* (ESRS 1 Paragraph 29).
4. 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 (ESRS 1 paragraph 32).
5. 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 (ESRS 1 paragraph 33).
6. 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 (ESRS 1 paragraph 34).
7. 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 1 paragraph 35).
8. Sustainability matters: when performing its materiality assessment, the undertaking shall consider the following list of sustainability matters covered in the topical ESRS. [...] 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. The undertaking, where necessary, also shall develop entity-specific disclosures on material impacts, risks and opportunities not covered by ESRS as described in paragraph 11 of this Standard (ESRS 1 AR 16).



9. 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 (ESRS 2 Paragraph 56).
10. 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-49 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 (ESRS 2 Paragraph 57).
11. 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 (ESRS 2 Paragraph 58).

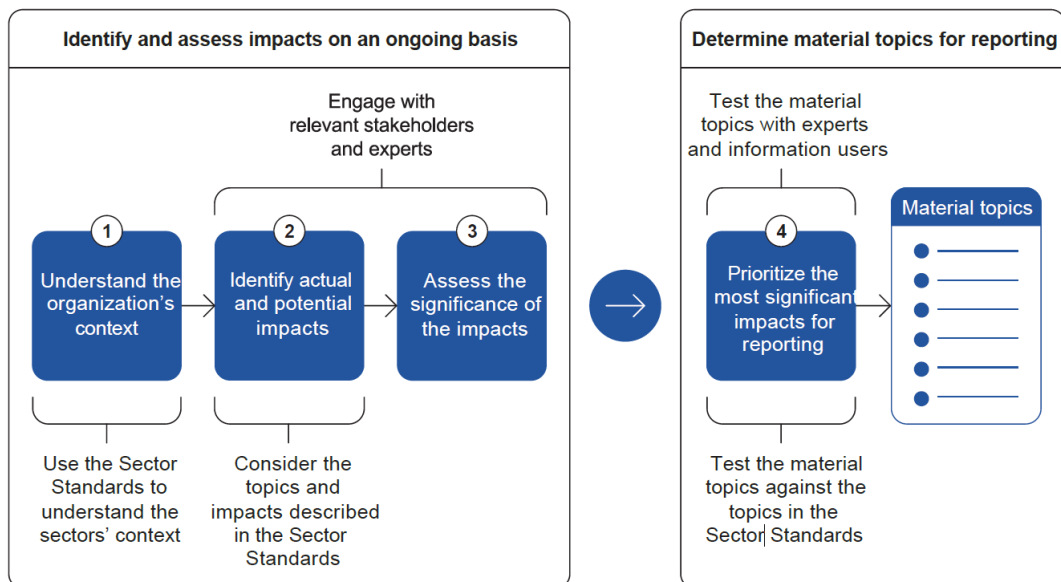


## Appendix 2: Background information – GRI approach to materiality at sector level

This text is a summary of the key points presented in “[GRI 3: Material Topics 2021](#)” pertaining to materiality at sector level. GRI approach is more similar to Approach B proposed than to Approach C.

1. An organization reporting in accordance with the GRI Standards is required to determine its material topics. When doing this, the organization is also required to use the applicable GRI Sector Standards (Requirement 3 in GRI 1: Foundation 2021 and Box 5 of GRI 3: Material topics 2021).
2. Companies should identify and assess impacts on an ongoing basis, using sector standards to understand the sectors ‘context and consider the topics and impacts described in these standards. Further, they should test the material topics they identify against the topics in the sector standards.

Figure 2. Process to determine material topics



3. GRI does not presume materiality of a topic or disclosure in its sector standards. Instead, sector standards are required to be used when determining the material topics, to inform that process, as per Box 5 below.





**Box 5. Using GRI Sector Standards to determine material topics**

The GRI Sector Standards provide information for organizations about their likely material topics. The topics have been identified on the basis of the sectors' most significant impacts, using multi-stakeholder expertise, authoritative intergovernmental instruments, and other relevant evidence.

The organization is required to use the applicable Sector Standards when determining its material topics (see [Requirement 3-b in GRI 1: Foundation 2021](#)). Using the Sector Standards is not a substitute for the process of determining material topics, but an aid. The organization still needs to consider its own specific circumstances when determining its material topics.

The organization is required to review each topic described in the applicable Sector Standards and determine whether it is a material topic for the organization.

There can be cases where a topic included in the applicable Sector Standards is not material for the organization. This may be because the organization assesses the specific impacts the topic covers to be absent. It may also be because, compared to other impacts of the organization, the ones that the topic covers are not among the most significant.

For example, an organization in the oil and gas sector is required to use *GRI 11: Oil and Gas Sector 2021* when determining its material topics. One of the topics included in this Sector Standard is land and resource rights. Oil and gas projects often require land for operations, access routes, and distribution. This can lead to impacts such as involuntary resettlement of local communities, which can involve their physical displacement and economic displacement through lost access to resources. However, if the organization's oil and gas projects do not result in these impacts and will not result in these impacts in the future, the organization may determine that the topic of land and resource rights is not a material topic for the organization. In such a case, the reporting organization is required to explain why it has determined that this topic, which is likely to be material for organizations in the oil and gas sector, is not a material topic for the organization.

If any of the topics that are included in the applicable Sector Standards have been determined by the organization as not material, the organization is required to list them in the GRI content index and explain why they are not material (see [Requirement 3-b-ii in GRI 1](#)). This explanation helps information users understand why the organization has determined that topics that are likely to be material for the organization's sectors are not material in its specific circumstances.

A brief explanation in the GRI content index of why the topic is not material is sufficient to comply with [Requirement 3-b-ii in GRI 1](#). In the previous example, the organization could explain that land and resource rights is not a material topic because its existing oil and gas projects are located in uninhabited areas, and there are no plans to start projects in new areas.

4. As per Box 5, when a topic presented in GRI sector standards is deemed non-material the organization is required to explain why it has determined that this topic is not material and is also required to list the non-material topics in the GRI context index. A brief explanation in the GRI content index is sufficient to meet the requirement.



## Appendix 3: Background information – IFRS S2 approach to materiality at sector level

1. In identifying the climate-related risks and opportunities that could reasonably be expected to affect an entity's prospects, the entity **shall refer to and consider the applicability** of the industry-based disclosure topics defined in the Industry-based Guidance on Implementing IFRS S2.
2. In preparing disclosures to meet the requirements in paragraphs 13–22, an entity **shall refer to and consider the applicability** of cross-industry metric categories, as described in paragraph 29, and industry-based metrics associated with disclosure topics defined in the Industry-based Guidance on Implementing IFRS S2 as described in paragraph 32.
3. The objective of climate-related financial disclosures on metrics and targets is to enable users of general-purpose financial reports to understand an entity's performance in relation to its climate-related risks and opportunities, including progress towards any climate-related targets it has set, and any targets it is required to meet by law or regulation. To achieve this objective, **an entity shall disclose: (a) information relevant to the cross-industry metric categories** (see paragraphs 29–31); (b) industry-based metrics that are associated with particular business models, activities or other common features that characterise participation in an industry (see paragraph 32); and (c) targets set by the entity, and any targets it is required to meet by law or regulation, to mitigate or adapt to climate-related risks or take advantage of climate-related opportunities, including metrics used by the governance body or management to measure progress towards these targets (see paragraphs 33–37).
4. An entity **shall disclose information relevant to the cross-industry metric categories** of: (a) greenhouse gases—the entity shall [...]
5. In identifying and disclosing the metrics used to set and monitor progress towards reaching a target described in paragraphs 33–34, **an entity shall refer to and consider the applicability of cross-industry metrics** (see paragraph 29) and industry-based metrics (see paragraph 32), including those described in an applicable IFRS Sustainability Disclosure Standard, or metrics that otherwise satisfy the requirements in IFRS S1.
6. Defined term **disclosure topic**: A specific sustainability-related risk or opportunity based on the activities conducted by entities within a particular industry as set out in an IFRS Sustainability Disclosure Standard or a SASB Standard.

