

DMA in the Revised ESRS: Simplification or Complication?

EFRAG Consultation Response on the Revised ESRS curated by Donato Calace, Datamaran

“If I seem unduly clear to you, you must have misunderstood what I said” Alan Greenspan once famously said. As I went through again and again the double materiality assessment (DMA) requirements and guidance across the Revised ESRS 1, ESRS 2, the new Non-Mandatory Illustrative Guidance (NMIG), and Basis for Conclusion, the former Fed Chairman’s words sarcastically echoed in my mind.

Every attempt to answer the question **“Is the DMA simpler now?”** always ended with a **“yes, but”**. There are certain parts of the process that would be easier or more straightforward (no more sub-sub topics!), and at the same time **new layers** of assessment added (looking at you **Gross v Net**), some nice sounding principles (avoid **undue cost or effort**) with ambiguous pragmatic implications, an **opaque “practical considerations”** section which leaves a back door to **unreasonable** assurance providers to **always ask for more**.

At the end of the day, you’ll still need to:

1. Conduct a DMA;
2. Update the DMA annually;
3. Identify and assess Impacts, Risks, and Opportunities (IROs)
4. Disclose IROs;
5. Disclose governance oversight over the material IROs;
6. Go through the assurance process for their DMA.

As you can gather, **I’m not fully convinced that the Revised ESRS are in fact delivering a substantial simplification of the DMA**, despite it being one of the key levers EFRAG actioned to simplify the ESRS. Don’t get me wrong, I’m not pointing fingers at the EFRAG Technical Expert Group and Sustainability Reporting Board here - I know many of them and I know for sure their hearts and minds are in the right place. They’re genuinely trying to make things clearer and easier. However, the combined political and time pressure of the revision process are the perfect cocktail to deliver good sounding headlines, like “68% reduction in datapoints” (which EFRAG’s Chiara Del Prete too agrees [is not a good way to measure how demanding the ESRS are](#)), while practitioners don’t get the improvements they actually need.

Fortunately, there’s still time to respond to EFRAG’s consultation, and an opportunity to really have a clearer and more straightforward DMA process.

If you'd like to read our recommendations on how to effectively deliver a simpler DMA process without compromising on its integrity, skip the next section and go straight to "[A simpler DMA is still possible](#)". If you're interested in the technical details, keep reading.

Why the Revised ESRS are not delivering a simpler DMA

EFRAG's Basis for Conclusions (pp 9-10) indicates that the "*lack of clarity*" related to DMA's "*operationalisation*" was identified as "*a significant source of burden in practice*". In particular, "*the determination of matters (or topics) to be reported upon has been particularly intense, including for audit purposes*", with "*excessive focus on process rather than outcome*", resulting in "*disproportionate effort compared to the result*."

For this reason, the Basis for Conclusions continues, modifications are introduced that "*should simplify the DMA process and enhance effectiveness of the materiality of information to a large extent*."

What are those modifications? I listed those down in the table below, scoring revisions in this way:

- a) +1 for those that effectively simplify the process;
- b) 0 for those that are simple editorial changes not introducing any change vs the current process;
- c) -1 finally for those that in fact add complications to the process.

If all the 15 revisions were in the direction of simplifying the process, the final score would be 15. According to my analysis, the final score is 2 out of 15. In other words, **the revisions made the process a meagre 13% simpler** - which doesn't sound at all "*a large extent*".

Revisions	Simplification (+1), no change (0) or complication (-1)?	Rationale	Reference (Revised ESRS)
ESRS are a fair presentation framework	0	Useful principle in theory, but unclear practical implications. If anything puts even more emphasis on the importance of identifying, assessing, monitoring, and disclosing material IROs - which already was pivotal in the DMA process.	ESRS 1 16

Revisions	Simplification (+1), no change (0) or complication (-1)?	Rationale	Reference (Revised ESRS)
Sub-sub topics now removed	1	Original AR 16 sustainability matters were overlapping and mixing different elements. Removing sub-sub topics removes complexity. Also clarified the illustrative nature of the list of topics. Hopefully this will be enough for auditors to stop using it as a checklist.	ESRS 1 Appendix A
When only a sub-topic is material, the undertaking should limit the information reported to that sub-topic without triggering the reporting of all the datapoints in the relevant topical standard	0	Useful clarification, but already used in practice - not a new simplification measure	ESRS 1 50 AR 21
Gross vs Net impact assessment	-1	Adds yet another layer of analysis	ESRS 1 34-35
Governance oversight	0	Governance oversight requirements on material IROs originally under ESRS 2 GOV-2 are now under ESRS 2 GOV-1	ESRS 2 GOV-1
Annual update	0	No real change from previous requirement	ESRS 1 29
New materiality of information principle	1	Materiality of information mechanism now more visible (+1 simplification), however the materiality test is still quite ambiguous (-1 complication)	ESRS 1 21
New materiality of information test	-1	Materiality of information mechanism now more visible (+1 simplification), however the materiality test is still quite ambiguous (-1 complication)	ESRS 1 21
Focus exclusively on "likely to arise" IROs in the value chain	0	This principle is already present in the current ESRS 1 para 39	ESRS 1 45
The undertaking is not required to assess every possible IRO	0.5	Potentially useful principle to use in pushing back excessive auditors' requests. Unclear how it translates to practice.	ESRS 1 46

Revisions	Simplification (+1), no change (0) or complication (-1)?	Rationale	Reference (Revised ESRS)
Use reasonable and supportable information that is available without undue cost or effort	0.5	Potentially useful principle to use in pushing back excessive auditors' requests. Unclear how it translates to practice (approach described in paragraph 89 is highly subjective).	ESRS 1 47
Clarification on the level of aggregation/disaggregation of IROs at country, site, asset level	1	Language on disaggregation has been relaxed, allowing for more opportunities to aggregate IROs when appropriate	ESRS 1 51-53
Bottom up vs top down approach	0	Already possible under existing ESRS. Also: why keep the bottom up approach if top down is more pragmatic and is expected to deliver the same results?	ESRS 1 48 AR 17
No need to analyze every time horizon and each characteristic of severity unless more information is necessary	0	Useful in theory, but the ambiguity of "unless more information is necessary" is likely to raise questions with the auditors	ESRS 1 48 AR 18
The use of quantitative information or quantitative scoring is not required in all cases.	0	Useful in theory, but ambiguous in its application, and thus likely to raise questions with the auditors	ESRS 1 48 AR 19
TOTAL (out of 15)	2	The process is now 13% simpler	

It is worth analyzing more closely the modifications concerning fair presentation, Gross v Net, materiality of information, and the new practical considerations section.

Fair presentation

ESRS 1 16 now clarifies that the ESRS are a “fair presentation” standard. In accounting jargon, fair presentation frameworks are different from compliance based standards as they focus on faithful representation, key characteristics of quality of the information, and management judgement rather than a detailed checklist of rules. In other words, in a fair presentation system substance takes precedence over form. This is probably music for the ears of all those companies that went through the implementation of ESRS and have been vexed by auditors applying a very literal interpretation of the requirements, in particular on the DMA (I’m looking at you, auditors asking for IROs for each AR16 sub-sub topic).

However, despite Patrick de Cambourg's [opinion](#), slapping the label "fair presentation" on top of the standards (it is literally header 2 in ESRS 1) doesn't change the fact that the ESRS are still full of very specific and detailed requirements, including on the DMA process. The concern is that this inherent contradiction could potentially lead to even lengthier debates with auditors.

Gross v Net

The Revised ESRS 34-35 seek to clarify how to take into account prevention, mitigation, and remediation measures when assessing negative impacts. Specifically, they indicate when assessment can be done on a net (taking into account mitigation/prevention actions) or gross (without taking into account mitigation/prevention actions) basis. In this effort to provide clarification, however, the Revised ESRS end up adding yet another layer of analysis, as reporting companies will need to determine the assessment basis on their negative impacts. To quote one of the practitioners in our [Harbor](#) community: "*now another dimension is added on top of the standard DMA exercise*".

ESRS 34-35 are dense paragraphs with a lot of information delivered in few lines, so I converted them in a table for improved understandability¹:

Type of Impact	Type of Action Considered	Assessment Basis	Source Text
Actual negative impacts	Mitigation/Prevention (taken before impact)	Net	<i>"The severity of the impact shall be evaluated considering the outcomes of any mitigation or prevention measures implemented before the impact occurred."</i>
Actual negative impacts	Remediation (during reporting period)	Gross	<i>"If the undertaking has taken remediation actions during the reporting period to address actual negative impacts, these actions shall not be considered when assessing the materiality of the impact."</i>
Persisting actual impacts from previous years	Mitigation/Prevention (taken before impact)	Net	<i>"The severity of the impact shall be evaluated considering the outcomes of any mitigation or prevention measures implemented before the impact occurred."</i>

¹ ESRS 1 Appendix C includes a table illustrating how to consider mitigation, prevention, and remediation actions, however it does not clarify the assessment basis (gross v net)

Potential negative impacts	Mitigation/Prevention (effective and not ongoing)	Net	<i>"When supportable evidence exists that mitigation or prevention actions taken reduce the severity and/or likelihood of potential negative impacts... the effect of these actions is considered in assessing the materiality of the impacts."</i>
Potential negative impacts	Mitigation/Prevention (effective but requires ongoing action)	Gross	<i>"If the undertaking needs to maintain significant ongoing mitigation and/or prevention actions... the impact shall be assessed without considering the mitigation and/or prevention actions."</i>
Potential negative impacts	Future Remediation or Policies	Gross	<i>"Future remediation actions and policies are not considered in the materiality assessment of potential impacts."</i>

An additional point of concern in this approach is the ambiguity of the formulation "significant ongoing mitigation and/or prevention actions". Determining what mitigation and prevention measures qualify as "significant" and "ongoing" clearly requires a judgement call, and it is very likely to generate long internal debates on what those characteristics mean as well as raise questions from assurance providers.

Materiality of information

In the original ESRS, the materiality of information test is well hidden in ESRS 1 31 and 34. As a result, it has been barely used by Wave 1 reporting companies. It is then a welcome revision to introduce the new paragraph 21 in the Revised ESRS 1 clearly spelling out the materiality of information filter. The revised ESRS modify also the materiality of information test, now based on 2 alternative conditions:

"Information is material when:

- a) omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make based on those reports, including financial statements and the sustainability statement; or*
- b) It is necessary for users of general purpose sustainability statements to understand the undertaking's material impacts, risks and opportunities and how it identifies and manages them."*

While condition a) is effectively borrowed from the IFRS standards and thus relies on well established understanding of what "general purpose financial reports" are, who "primary users"

are (i.e. investors and capital lenders), and which “*decisions*” it refers to (buy, hold, or sell equity or debt), b) is instead venturing in uncharted waters. Who are the “*users of general purpose sustainability statements*”? Are those different from the “*affected stakeholders*”? What are “*general purpose sustainability statements*”? And finally, most importantly, the test is predicated on a much broader and generic basis - “*understand the undertaking’s material impacts, risks and opportunities and how it identifies and manages them*” - compared to the more specific “*information that could reasonably be **expected to influence decisions***”. Arguably, the universe of information useful to “**understand**” IROs is much broader than the information “**expected to influence decisions**”, significantly diminishing the effectiveness of this new materiality of information filter, as it will be rather simple for auditors to insist that a piece of information is necessary to “**understand**” an impact, a risk, or an opportunity.

Practical considerations

This section includes a number of principles (rather than “practical considerations”) in 45-47 that are in theory useful to avoid over working the DMA and pushing back excessive auditors’ requests, such as:

- Focus the value chain assessment on areas where material IROs are likely to arise (although this indication is already in the current ESRS 1 39 and that did not stop certain auditors to ask companies to include every supplier and customer in the scope of the DMA);
- The undertaking is not required to assess every possible impact, risk and opportunity (everybody agrees, but how does this translate into practice?);
- use reasonable and supportable information that is available without undue cost or effort² (the definition of undue cost or effort in ESRS 1 89 is highly subjective).

Given their abstraction, the effectiveness of those principles dressed as practical considerations remains a question mark, especially considering the overreaching attitude auditors’ adopted in providing assurance to Wave 1 CSRD statements.

ESRS 1 48 and related application requirements then introduce measures through which “*the undertaking **may** avoid unnecessary complexity*”. The formulation based on “may” rather than “shall” already downgrades those measures to optional ones, which some auditors may interpret as: “only certain companies **may** use the lighter process described in ESRS 1 48, and there have to be companies out there that in light of their complexity, reach, size, must do more than that”.

Similarly, AR 17 does nothing to remove the ambiguity: “*The undertaking **may** adopt a top-down or a bottom-up approach to perform its materiality assessment.*” This is really puzzling considering the follow up comment: “*Adopting a **top-down approach** may be **more pragmatic** and **reduce the complexity** of the process, and **is expected to lead to the same outcome** of the materiality assessment as the bottom-up approach.*” If that is the case, **why on earth is the**

² Editorial note: 45 (b) and 47 use inconsistent language to refer to “reasonable and supportable evidence (45 b) / information (47)”, with only 47 adding the reference to “undue cost or effort” - I assume it applies to both paragraphs.

bottom-up approach still in the standards? Its presence, together with the “may” based language of these provisions, leaves a back door open to auditors to ask for a bottom-up approach whenever they deem it appropriate. More worryingly, one practitioner highlighted to me that certain auditors may even interpret this AR as a stress test, asking the reporting company to conduct both the top down and bottom up approach and check that the results effectively match.

Additionally, AR 18 is worded in a highly problematic way. ***“Unless more investigation is necessary to be able to determine that an impact, risk, or opportunity is material, then undertaking does not need:***

- a) to analyse every time horizon for all impacts, risks and opportunities;*
- b) (for impacts) to analyse separately each characteristic of severity”*

While a) and b) are welcome clarifications that can be used to effectively push back on certain auditors’ literal interpretation of the standards, making those 2 measures conditional to the ambiguous **”unless more investigation is necessary”** reduces substantially their reach. More importantly, considering that auditors may potentially ask for more investigation on any IRO, it’s probable prudent companies may conclude that they do need to apply a) and b) just to be ready in case of auditors’ requests for further investigation.

In short, while those practical considerations try to move in the right direction, their formulation in the Revised ESRS is not ambitious and clear enough to effectively deliver the necessary simplification.

Not by chance, those points have been largely echoed by the Datamaran community of sustainability practitioners on [Harbor](#).

A simpler DMA is still possible

It is not all doom and gloom. There’s still time until the end of consultation to effectively deliver a simpler DMA process. These are our recommendations:

1. Truly embrace a “fair presentation” regime, with a principle based approach and less detailed requirements - see next points for more details;
2. In line with a “fair presentation” regime, avoid overworked rules on Gross v Net, likely to generate time consuming debates internally and with auditors. The ESRS can indicate a blanket approach - i.e. all impacts are assessed on a gross basis - and leave it open for companies to make exceptions by providing a justification.
3. With regards to materiality of information, it is unclear why the Revised ESRS depart from the well established decision usefulness criteria in condition b). The test could be formulated as: “information is material when omitting, misstating or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose sustainability statements make based on those reports, including the undertaking’s material impacts, risks, and opportunities”

4. Clarify that the undertaking and the undertaking only can make the following judgement calls:
 - a. Value chain areas where material IROs are likely to arise;
 - b. The number of IROs identified and assessed;
 - c. What constitutes reasonable and supportable information available without undue cost or effort
5. Paragraph 48 should be based on a “shall” logic rather than “may”
6. Remove the bottom-up approach as it is evidently superfluous and unnecessarily more demanding than the top-down one.
7. Remove “unless more investigation is necessary” from AR 18

About Datamaran

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