

## **ACCOUNTANCY EUROPE'S CONTRIBUTION TO EFRAG'S DRAFT IG1: MATERIALITY ASSESSMENT IMPLEMENTATION GUIDANCE**

- (1) Accountancy Europe is pleased to contribute to EFRAG's draft IG1: *Materiality Assessment Implementation Guidance* (MA IG). We welcome this draft MA IG as it provides guidance on a key concept in the European Sustainability Reporting Standards (ESRS). Indeed, we have been calling for this guidance on the previous ESRS consultations too.
- (2) We acknowledge that guidance issued by EFRAG is limited to providing clarifications and illustrations to the ESRS as it will be a non-authoritative guidance. Interpretations are outside of EFRAG's mandate and fall instead under the European Commission's (EC) remit. This caveat informs our comments as summarised below.
- (3) We welcome the MA IG and appreciate it:
  - a. references international principles
  - b. clarifies some key elements on the materiality assessment
  - c. provides a roadmap and shares good practice steps to help companies design and undertake such a process.
- (4) However, we believe that there is room to further improve the MA IG to ensure it is comprehensive and a useful tool in applying ESRS. We have categorised our suggestions for improvement in two main categories:
  - a. "Comments to address before the finalisation of the MA IG", and
  - b. "Comments to address in future revisions of the MA IG"

We have adopted this classification as we believe that the MA IG should be finalised as soon as possible to help stakeholders, particularly those already using the ESRS which are effective since 1 January 2024. We recognise that some suggestions may take longer to tackle as they are more complex and represent newer areas, however, we think that this should not hold back the first publication of the MA IG.

### **COMMENTS TO ADDRESS BEFORE THE FINALISATION OF THE MA IG**

- (5) Accountancy Europe suggests the MA IG includes more guidance and illustrative examples on the following key matters before finalisation (see our rationale in the paragraphs below):
  - a. incorporating the value chain in the materiality assessment
  - b. distinguishing between material matters and the materiality of information
  - c. linking users and stakeholders
  - d. understanding the financial aspect of double materiality.

## **Value chain in the materiality assessment**

- (6) We appreciate EFRAG's draft IG2: *Value Chain Implementation Guidance* (VC IG). We reiterate our comments to the VC IG (see [here](#)) and call for more guidance and illustrative examples on how to incorporate value chain when making materiality assessments, particularly how far in the value chain to go.

## **Material matters vs materiality of information**

- (7) We suggest EFRAG include examples on what is considered "material information to disclose" in the spirit of paragraph 31 of ESRS 1 *General requirements* (ESRS 1), for example, by further expanding on "Step D: Reporting" as per paragraphs 97 - 98 of the MA IG.
- (8) In line with the above, we suggest expanding more on paragraph 1 of the Summary of the MA IG in making the distinction between material matters and material information. Such additional guidance and examples would help better understand paragraphs 25 - 36 "Material matters and materiality of information" of ESRS 1.
- (9) It would also be useful to explain the relationship between "significant" and "material", two terms that in financial reporting come together. EFRAG could provide an example of a case where information that is not "significant" is material to the users or vice-versa.
- (10) In addition, we call for more guidance and examples on disclosing the datapoints in each disclosure requirements, particularly how to ensure that the objective of the disclosure requirement is also met. In line with this, we noticed that the examples in paragraph 46 regarding relating "harmful chemical substances" or "pollution of water" stop at the level of the disclosure requirement. It would be useful for EFRAG to build on this example and incorporate the materiality of datapoints and the consideration of "meeting objective of disclosure requirement".

## **Users and affected stakeholders**

- (11) Accountancy Europe welcomes EFRAG's guidance in paragraphs 99 - 109 of the MA IG, including the clarifications that the materiality assessment considers affected stakeholders. However, we continue to insist that there is a need to link the reporting with the users of the report. For the materiality assessment, it is important to also ensure that the relevant users of the sustainability report are included in the various groups of stakeholders considered during the process.
- (12) To this end, we would have appreciated guidance and examples that clarify whether and how "other users of sustainability statements" as per paragraph 22 of ESRS 1 are considered in the materiality assessment (perhaps in relation to "affected stakeholders"), as well as in determining the information to report.
- (13) Lastly, we appreciate the stakeholder considerations as per paragraphs 99 - 109 of the MA IG. However, we suggest EFRAG clarifies that the impact materiality assessment should not be based solely on affected stakeholders, despite them being considered. In addition, we call for more guidance and illustrative examples on stakeholder engagement, including:
  - a. the extent a preparer can or should rely on stakeholder engagement
  - b. how far to go
  - c. how to select stakeholders in a way that ensures an unbiased outcome of the outreach and analysis

- d. whether there are any trade-offs between views and interests of different stakeholders
- e. any references to other initiatives/literature that may be instructive for the process.

### **Financial aspect of double materiality**

- (14) Whilst we welcome and appreciate the guidance on the “impacts” side of double materiality in the MA IG, we suggest developing more guidance on and providing more examples for the “financial” side too. In doing so, we suggest EFRAG collaborates with the International Sustainability Standards Board (ISSB) (see our comments in paragraphs 32 – 34).
- (15) It would have been useful to better understand how to identify, assess and report on “risks and opportunities”, and particularly “opportunities”, which is a rather new area. In addition to that, “opportunities” also border on sensitive information, and as a result reporting on some of them can be exempt as per section 7.7 of ESRS 1.

### **Figures in the MA IG**

- (16) We suggest EFRAG revises Figure 1 B) as we found it very confusing. Specifically:
  - a. the first three bold arrows in the top of the figure may be an error as they indicate the materiality assessment outcome yet at the “IRO universe” stage
  - b. the first and second arrow in the legend is not included in the figure
  - c. the definition for the use of the penultimate arrow in the legend as it seems to suggest that the materiality assessment influences the business model, strategy and management decisions; to mitigate this, EFRAG may simply use “expected/potential influence” in the wording.
- (17) We also suggest that EFRAG incorporates the “impacts” and “financial” lens of double materiality as this too would be a useful link. This could be done by simply including the label “impact materiality” on top of the box “material impacts”, and similarly, include the label “financial materiality” on top of the box “material risks and opportunities”.
- (18) In addition, in explaining this figure, we call for more guidance on how the universe of impacts, risks and opportunities is filtered to material ones.
- (19) On another note, to better illustrate Figure 1 A) we call for more examples from only one perspective. It would be also useful to connect this figure with the examples of paragraphs 37- 38 of the MA IG. Regarding these paragraphs, we suggest EFRAG also includes the reporting consequences to complete these examples.
- (20) Lastly, in Figure 1 C) the boxes for impacts and risks and opportunities are unconnected. This may be interpreted as indicating that there:
  - a. is no need to identify whether a material impact leads to a material risk and opportunity, and/or
  - b. are no material matters from such a relationship, and as a result, such risks and opportunities would not have to be reported.

- (21) We call on EFRAG to reconsider this figure and ensure this relationship is fairly represented. From our understanding of ESRS and other paragraphs in this guidance, identifying risks and opportunities that may arise from impacts is always necessary and a part of the materiality assessment process.

### **Gross vs net considerations**

- (22) We welcome FAQ 23 and we understand that the materiality assessment needs to consider impacts on a gross basis. However, we noticed that the wording in paragraphs 215 – 219 may be interpreted differently (e.g. the second sentence in paragraph 218). To further clarify this point and avoid misinterpretations, we suggest EFRAG reviews the wording for inconsistencies and explicitly acknowledges in the MA IG that an impact is not automatically netted for cases where there are laws in place that try to tackle the impact.
- (23) In addition, we suggest EFRAG also extends such guidance to the financial aspect of materiality.

### **Other comments**

- (24) We suggest EFRAG runs a final review of the document to ensure that the correct ESRS references and spirit of provisions are cited. For example, we noticed that entity-specific information is left out of paragraph 43(c). In another example, paragraph 158 of the MA IG states that “[...] *financial effects that arise from risks and opportunities are to be reported irrespective of their accounting treatment*” may not be fully in line with the ESRS or even FAQ 5 of the MA IG. Other examples include paragraph 13(b), the second paragraph in the text box in page 14, the title of Step B in Figure 3, paragraph 97(c) which may suggest that the consolidation thresholds have to be reported too, paragraph 215, etc.
- (25) Regarding FAQ 7 we suggest EFRAG revises the wording of paragraph 161 as it may be read as contradicting paragraph 160. In addition, we suggest EFRAG be more specific and provide examples when stating that the materiality assessment “needs to be updated on an ongoing basis” to understand the conditions that lead to an update.
- (26) In FAQ 19, paragraph 200 refers to the ESRS sectors and indicates they are a “more appropriate as a starting point”. However, as the ESRS sectors have not yet been defined, we call for EFRAG to provide examples and guidance on how to disaggregate in the meantime.

### **COMMENTS TO ADDRESS IN FUTURE REVISIONS OF THE MA IG**

- (27) Based on paragraph 220 of the MA IG, we understand that EFRAG may issue future guidance on making materiality assessments for social topics. We agree that this may be a complex topic to tackle in this MA IG, however, strongly suggest EFRAG prioritises providing guidance on this topic. It is paramount to have more examples and guidance, including references of methodologies/frameworks/standards the entity can use to comply with the requirements.
- (28) On another note, and in line with our comment in paragraph 6 above, we call for more guidance and illustrative examples on value chain considerations in the materiality assessment for financial institutions, conglomerates and multinational enterprises. These companies have complex value chains, and determining how far in the value chain to go is a particularly challenging aspect. We call for further clarity specifically for the financial sector, including via the respective sector-specific standard, as soon as possible.

### *Group and consolidation considerations*

- (29) Accountancy Europe believes that more guidance is needed overall on consolidation, including making group materiality assessments and reporting consolidated information. We suggest EFRAG considers

whether it can provide more comprehensive guidance within its remit on this topic, and if not, we suggest EFRAG brings this forward with the EC as we appreciate that this may be a case for interpretation or further elaboration in the ESRS.

- (30) Recognising the above caveat and for the purposes of the MA IG, we call for more guidance and examples on:
- a. the "significant differences" between material impacts, risks and opportunities at group level and at one or more of the subsidiaries (notably regarding financial materiality), in line with chapter 7.6 of ESRS 1
  - b. approaches and considerations in determining material risks and opportunities for the group; for example, how to proceed if the consolidated result of material risks and opportunities identified at subsidiaries level in a bottom-up approach, may not be material for the group?
  - c. how to consolidate impacts, risks and opportunities, including how to aggregate and disaggregate
  - d. setting thresholds, including whether they should be set at group or subsidiary level; for example, should a material impact at subsidiary level also be deemed material at a group level, i.e., both group and subsidiary use the same thresholds? How would this work for material risks and opportunities where differences between subsidiary and group are more likely due to the financial aspect?
- (31) On another note, we invite EFRAG to clarify in FAQ 13 how a parent company of a conglomerate "has to consider an appropriate level of consistency in methodologies and thresholds across the entire group". It is important to understand what is meant in practice by "an appropriate level of consistency" and how to reach that objective, particularly as different entities within the group may have different interpretations of severity and its elements.

#### **ALIGNMENT WITH INTERNATIONAL STANDARDS**

- (32) Whilst we find the MA IG very useful, we regret that the good collaboration with the International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI) when developing the ESRS was not extended to these projects.
- (33) Particularly, we believe that the guidance on the financial aspect of double materiality is a shared concept with the ISSB's standards too, despite recognising that the ISSB has not advanced in providing specific further guidance. Both ESRS and the ISSB standards were aligned to the maximum extent possible and uses the same terminology and definition for "financial materiality".
- (34) Therefore, we strongly suggest EFRAG engages with the ISSB and GRI to ensure that their respective guidance are aligned. Alignment of guidance in addition to that of the standards will ensure homogeneous application of the respective standards.
- (35) On a separate note, we invite EFRAG to reconsider the wording in paragraphs 123 – 124 as well as paragraphs 154 – 156 of the MA IG (of what we believe corresponds to FAQ5 due to a typo) when talking about financial materiality in the financial statements. We believe that EFRAG should not provide an interpretation on financial reporting matters either. In addition, it may conflict with the scope and outcome of the International Accounting Standards Board's (IASB) upcoming project *Climate-related and Other Uncertainties in the Financial Statements*.

- (36) For example, paragraph 156(a) of the MA IG may suggest that financial reporting ignore a significant risks and opportunities in the medium- or long-term, when in fact, it could be disclosed in the notes despite it not resulting in the recognition, derecognition or remeasurement of an asset or liability.

#### **COMMENTS FOR FUTURE CONSIDERATION**

- (37) We welcome that the MA IG includes separate sections, one on clarifications and the other on FAQ. We also congratulate EFRAG on launching its Q&A platform to support the ESRS implementation. We understand that EFRAG's intent is to regularly publish reports that answer the recurring questions submitted.
- (38) Nonetheless, we believe that the FAQs in the MA IG and the Q&As in the platform, may be duplicative and repetitive to the purposes of each of these initiatives as well as create confusion given that the EC has not clarified the status of either of these initiatives. Therefore, we suggest EFRAG reworks some FAQs as simple guidance. Indeed, some see FAQs as having a lower authority than the guidance and not consider them when implementing ESRS. This could raise discussions between the stakeholders in the reporting ecosystem as well as impair comparability.
- (39) We believe that in the future, clarifications could be incorporated in the respective ESRS, when the first set is open for revision as these merit respective amendments. The MA IG could therefore serve to explain and illustrate how to make judgements. Should there be any FAQ content in the MA IG that would not be fit as guidance annexed to the ESRS, EFRAG should include them in its work on the Q&A Platform.
- (40) It is also important to consider that ESRS reporting will advance as stakeholders gain more experience. However, there is value in sharing good real-life practices as these will help other stakeholders advance too. This could be done via EFRAG's old European Lab, which could be reactivated.
- (41) In addition, EFRAG must not lose sight of its main standard-setting duties, including issuing the Basis for Conclusions for the ESRS. Whilst we understand that the standards' Basis for Conclusions are not adopted in law, they are valuable to understand the rationale behind the final standards' provisions. They are also part of the due process and enhance trust in it. Therefore, we encourage EFRAG to collaborate with the EC to update the Basis for Conclusions and include the EC's rationale when making the final changes.

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#### **ABOUT ACCOUNTANCY EUROPE**

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