EFRAG

European Financial Reporting Advisory Group

[Draft] European Sustainability Reporting Standard 4 Sustainability material impacts, risks and opportunities

DISCLAIMER

This working paper is an Appendix to and must be read in conjunction with the related document '*PTF-ESRS Batch 1 working papers – Cover note and next steps*', which establishes the general context, the status of this working paper and the subsequent due process steps to be followed.

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[Draft] European Sustainability Reporting Standard 4

Sustainability material impacts, risks and opportunities

Objective

1 A reporting undertaking must determine its material sustainability impacts, risks and opportunities. Disclosure Requirements for material sustainability impacts, risks and opportunities may be specified by standards that are applicable for all undertakings (sector-agnostic standards), for undertakings in a specific sector (sector-specific standards), might not be covered by a specific standard at all (entity specific) or might not be covered by a standard yet. In the latter two cases the undertaking must determine entity specific disclosures.

2 The objective of this [draft] standard is to support undertakings in identifying material sustainability impacts, risks and opportunities and to specify disclosure requirements for the description by the undertaking of:

(a) its processes to identify material sustainability impacts, risks and opportunities,

(b) its material sustainability impacts, risks and opportunities that are mandated to be disclosed by topical standards or standards that are specific for the sector the undertaking is in

(c) its material, entity specific sustainability impacts, risks and opportunities not covered by any standard, as well as

(d) setting characteristics of quality of entity specific disclosures.

Interaction with other ESRS

3 **All disclosure requirements related (i) to the identification of material sustainability impacts, risks and opportunities and (ii) to the elaboration of disclosures of entity-specific sustainability impacts, risks and opportunities are described in this ESRS.**

4 Once identified, those material sustainability impacts, risks and opportunities are considered by the undertaking to deploy prevention, mitigation, adaptation and other management measures. This may imply strategic decisions, governance consideration, the establishment of policies, targets, action plans and allocation of resources as well as the use of metrics to monitor the evolution of impacts, risks and opportunities over time, and all of the above addressed by other ESRS. Interactions, when applicable, between these standards are indicated in the respective ESRS.

Disclosure Requirements

Disclosure Requirement 1 - Description of the processes to identify material sustainability impacts, risks and opportunities

5 The undertaking shall provide a description of its processes to identify its material sustainability impacts, risks and opportunities.

6 The principle to be followed under this disclosure requirement is to provide information on how the undertaking is organising its assessment of sustainability matters that result in material sustainability-related impacts, risks and opportunities (i) in relation to disclosures mandated by relevant sector-agnostic and sector-specific applicable standards as well as (ii) in relation to potential additional disclosures necessary at entity-specific level, because appropriate disclosures must be determined also with regard to the undertaking's specific facts and circumstances in relation to the impact, risks or opportunities. The primary objective of this assessment is to establish a robust basis of the undertaking's sustainability reporting in terms of comprehensiveness and quality. When performing its assessment, the undertaking is expected to give equal importance to its decisions related to existing mandated disclosures and to potential additional disclosures. Assessment processes generally address both dimensions at the same time on a matter-by- matter basis.

7 The disclosures required by paragraph 5 shall include first an acknowledgement of double materiality as the pivotal principle followed for the undertaking's assessment, including a description of how this principle is embedded in practice in the steps leading to the undertaking's final assessment supporting its sustainability reporting.

8 To embed double materiality in practice as the pivotal principle for the assessment of impacts, risks and opportunities, the processes established by the undertaking need to reflect and onboard the principles established by the CSRD as further developed by ESRS. With respect to material sustainability impacts, risks and opportunities these processes shall consider in particular, the following aspects of double materiality:

(a) Sustainability matters can result in sustainability-related impacts, risks and opportunities for the undertaking. A sustainability matter is a specific dimension of sustainability under which the undertaking impacts people or the environment (impact materiality) or which results in risks or opportunities for the undertaking that affect or may affect its financial development, performance and position (financial materiality). Sustainability topics are structured groups of sustainability matters that on the highest topical level are grouped into environmental, social and governance topics, as defined in the CSRD.

(b) A sustainability matter can be material from an impact materiality perspective, from a financial materiality perspective or from both perspectives.

(c) Materiality is to be understood as the criterion for prioritisation and inclusion of specific information into corporate reports. Materiality reflects (i) the significance of the information in relation to the phenomenon it purports to depict or explain, as well as (ii) its capacity to meet the needs and expectations of the stakeholders of the undertaking and of the undertaking itself allowing for proper decision-making and more generally (iii) the needs for transparency corresponding to public interest. The implementation of materiality may imply the use of thresholds and/or criteria.

(d) In the materiality assessment processes, equal importance should be given to impact materiality and financial materiality. To determine whether a sustainability matter is material it must be analysed both from the impact and from the financial materiality perspectives. Accordingly, undertakings need to set up processes both from the impact materiality and from the financial materiality perspective to decide on materiality of sustainability topics. Both processes should be performed in parallel and in inter-relation to determine whether a sustainability topic is material or not.

(e) The undertaking should screen the ESRS for sustainability matters and structure them before performing the materiality assessment.

(f) For each sustainability matter, the undertaking should identify the relevant stakeholders and users and their information needs, as the basis for the process of determination of the materiality of the matter and if necessary, the development of related entity specific disclosures. The materiality assessment process should ensure that impact on *all* affected stakeholders is taken into account and not only the needs of users.

(g) Materiality of a sustainability matter shall be assessed over the value chain and over the short-, medium- and long-term time horizon. A sustainability matter or information is material from an impact perspective if it concerns actual or potential significant impacts directly caused or contributed to, by the undertaking, as well as impacts which are otherwise directly linked to the undertaking's entire upstream and downstream value chain, regardless of the undertaking's contribution to it.

(h) The materiality of sustainability matters from an impact perspective shall be considered based on the severity of an actual negative impact, which is determined by scale, scope and irremediable character of the impact, and, the severity as well as likelihood of a potential negative impact.

9 In addition to the acknowledgement required by paragraph 7, the disclosure required by paragraph 5 shall include detailed explanations related to the organisation and processes put in place by the undertaking to assess its impacts, risks and opportunities under the required double materiality approach, including the following:

(a) a description of the organisation put in place for and resources dedicated to the assessment, including comparing the organisation and resources put in place in relation to the size and activities of the undertaking,

(b) a description of the methodologies adopted and of the processes implemented for the assessment, including the related internal control procedures and the decision-making steps, through

i. an overview of the due diligence process used to identify potential and actual impacts on economy, environment and people connected with the undertaking together with an overview of the process used to identify sustainability risks and opportunities that affect or may affect its financial development, performance and position, and

ii. an explanation of how the undertaking has determined (i) which identified potential and actual impacts on economy, environment and people connected with the undertaking and (ii) which sustainability risks and opportunities that affect or may affect its financial development, performance and position are material,

(c) an explanation about the involvement of, and engagement with, (i) stakeholders to understand the ways in which they may be impacted as well as (ii) internal and external experts, and

(d) the latest and future revision dates of the assessment.

Disclosure Requirement 2 - Outcome of the undertaking's assessment on material sustainability impacts, risks and opportunities as identified by reference to and in compliance with sector-agnostic and sector-specific level ESRS

10 **The undertaking shall provide a description of the outcome of its assessment processes as regards mandatory disclosures under ESRS with a particular emphasis on relevant explanations on why certain mandatory disclosures are not material under the undertaking's specific facts and circumstances and therefore disclosed as such.**

11 The principle to be followed under this disclosure requirement is to give a clear statement of sustainability matters, as reflected by all ESRS, that are material, and to give relevant explanations on (i) why certain mandatory disclosures are not material under the undertaking's specific facts and circumstances and therefore disclosed as such and (ii) why certain material disclosures on matters that due to their importance are prioritised and monitored directly by the undertaking's governing bodies.

12 When the undertaking performs its assessment, impacts, risks and opportunities shall be considered as falling under one of the three following categories:

(a) those that are deemed by ESRS as material to all undertakings regardless of their sector and therefore subject to mandatory disclosure requirements for all undertakings (i.e. sector-agnostic level),

(b) those that are deemed by ESRS as material to most undertakings within specific sectors and therefore subject to mandatory disclosure requirements for those undertakings (i.e. sector-specific level), and

(c) those that can be material for some or even a significant number of undertakings within a specific sector or across sectors, but where ESRS have considered that relevant disclosures shall be subject to the undertaking's assessment of their materiality based on the undertaking's specific facts and circumstances (i.e., entity-level), and accordingly miss disclosure requirements mandated by ESRS.

13 For the above first two categories the undertaking, given its specific facts and circumstances (strategy, business model, products and services, markets, value chain, key drivers of value creation, stakeholders), shall determine whether each sector-agnostic or sector-specific ESRS mandatory disclosure, is material or not. For the undertaking mandatory disclosure requirements established by ESRS shall be presumed to cover a material impact, risk or opportunity and therefore shall justify a full disclosure on the basis prescribed by the related ESRS. In order to take into account the undertaking's facts and circumstances and the outcome of its assessment processes as well in order not to overburden sustainability reports, such a presumption is rebuttable on the basis of appropriate evidence and the undertaking shall assess for each ESRS disclosure requirement:

(a) if a full disclosure is necessary as prescribed by the related ESRS, or

(b) if the presumption for a full disclosure is rebutted on the basis of appropriate evidence and if as a consequence the required disclosure is complied with, with a simple statement that the disclosure requirement is "not material for the undertaking".

14 The level of appropriate evidence to be obtained during the assessment processes depends (i) upon the nature of each of the sustainability matters covered by sustainability reporting and (ii) its link with the undertaking's facts and circumstances, in particular its business model(s), as disclosed following ESRS 2. Reasonable judgement shall be exercised by the undertaking as to the extent of evidence gathering needed. Under many situations it may be considered a simple and straightforward judgement that the ESRS disclosure requirement shall be complied with in full or as "not material for the undertaking". Under other situations as well as in case of doubt a simple and straightforward judgement will not be sufficient and the undertaking shall perform additional appropriate evidence gathering steps.

15 The "not material for the undertaking" disclosure may cover (i) disclosures that are effectively nil as well as (ii) disclosures which are not meaningful and decision-useful for stakeholders without being nil. It may be applicable to a disclosure requirement as a whole, or to a disclosure requirement in part (covering certain specified elements of a disclosure requirement). The undertaking shall establish explicit thresholds and/or criteria to establish when a disclosure is not material. When required by an EU legislation or regulation, or by any other authoritative instrument, a mandatory disclosure requirement cannot be assessed as not material.

16 The third category described under paragraph 12 (c) is covered by Disclosure Requirement 3 below.

17 When performing its assessment, the undertaking shall consider:

(a) its underlying actual and potential, negative and positive impacts on the economy, environment, and people, based on their severity and likelihood, with equal consideration of impacts with which the undertaking is involved with through its activities as well as a result of its business relationships,

(b) its underlying sustainability-related financial risks and opportunities, including how:

i. material sustainability-related risks and opportunities have affected the undertaking's financial performance, position and cash flows,

ii. the undertaking expects financial performance, position and cash flows to change over time as a consequence of material sustainability-related risks and opportunities,

iii. the undertaking is exposed to the risk or how the undertaking intends to pursue the opportunity, and

iv. the risk and opportunity are measured and monitored, including any uncertainties and assumptions connected to their measurement and monitoring,

(c) the sustainability matters that due to their importance to the undertaking are prioritised and monitored directly by the undertaking's highest governing bodies. A material impact, risk or opportunity that due to its importance to the undertaking is prioritised and monitored directly by the highest governing body is an impact, risk or opportunity the severity or magnitude of which has or is likely to have consequences on the strategic decisions made or to be made by the undertaking. These impacts, risks or opportunities are distinct from impacts addressed by regular management decisions and they deserve a specific disclosure focus, as required by ESRS 2 and ESRS 3.

18 The disclosure required by paragraph 10 shall include the following information:

(a) a clear statement of sustainability matters, as reflected by all ESRS, that are material to the undertaking, including:

i. description of the underlying actual and potential, negative and positive impacts on the economy, environment, and people, including whether the undertaking is involved with the negative impacts through its activities or as a result of its business relationships, and describe the activities or business relationships;

ii. description of the underlying sustainability-related financial risks and opportunities, including how:

1. material sustainability-related risks and opportunities have affected the undertaking's financial performance, position and cash flows;

2. the undertaking expects financial performance, position and cash flows to change over time under effects of material sustainability-related risks and opportunities;

3. the undertaking is exposed to the risk or how the undertaking intends to pursue the opportunity

(b) a list of the sustainability matters that due to their importance are prioritised and monitored directly by the undertaking's highest governing body assessed as being of strategic significance as defined under ESRS 2 and which as a consequence require specific focused disclosures, together with a summarised explanation of how, among all sustainability impacts, risks or opportunities related to its activities and covered by sector-agnostic or sector-specific ESRS, the undertaking has identified the material sustainability impacts that, due to their importance, are prioritised and monitored directly by the highest governing bodies,

(c) a list of the disclosure requirements that are complied with a "not material for the undertaking" disclosure, with a clear indication as to the application of the rebutted presumption and the reason why it is rebutted (i) to a disclosure requirement as a whole or (ii) to specified elements of a disclosure requirement. The mandatory disclosures complied with under a full disclosure are by contrast presumed to be confirmed as related to material impacts, risks and opportunities following the undertaking's assessment processes. The thresholds and/or criteria retained by the undertaking to determine materiality in relation to mandatory requirements shall be disclosed, and

(d) an explanation of the changes to the lists as compared to the previous reporting period.

Disclosure Requirement 3 - Outcome of the undertaking's assessment of material sustainability impacts, risks and opportunities that are not covered by an ESRS (entity-specific level)

19 **The undertaking shall provide a description of the outcome of its assessment process as regards material impacts, risks and opportunities that are entity specific and require disclosure.**

20 The principle to be followed under this disclosure requirement is to provide information (i) about all material impacts, risks and opportunities of the undertaking resulting from the undertaking's specific facts and circumstances for which relevant disclosure requirements do not exist, and (ii) about those among them that due to their importance are prioritised and monitored directly by the undertaking's governing bodies.

21 Based on its specific facts and circumstances the undertaking shall determine, whether it has additional entity-specific material impacts, risks and opportunities to disclose, which ESRS have not specified in full or in part disclosures necessary for understanding them. For each sustainability matter in the scope of sustainability reporting, the undertaking shall therefore assess which material impacts, risks and opportunities are not covered by ESRS and shall give rise to entity-specific disclosure. This assessment shall be performed at the same time as the assessment related to mandatory disclosure requirements under ESRS.

22 The fundamental aspects of double materiality, as described under paragraph 8 (a) to (h) above, shall be considered by the undertaking when determining its entity-specific material impacts, risks and opportunities.

23 The disclosure required by paragraph 19 shall include the following information:

(a) a list of all impacts, risks and opportunities assessed as material on the basis of its specific facts and circumstances which are not covered by ESRS disclosure requirements including mentioning which of those are prioritised and monitored directly by the undertaking's highest governing bodies as described under paragraph 18 (b), together with a summarised explanation of how the undertaking has identified those,

(b) a summarised description of the nature of these entity-specific material impacts, risks and opportunities, explaining why the undertaking considers them material. It shall include how prioritisation of negative impacts reflected their relative severity and likelihood, and a description of the nature of the involvement of the undertaking with these entity-specific material impacts, risks and opportunities. It shall include also whether the undertaking is involved with the negative impacts through its activities or as a result of its business relationships, and describe the activities or business relationships,

(c) a summarised description of the substance/objective of the disclosures related to these impacts, risks and opportunities, and

(d) an explanation of the changes to the list as compared to the previous reporting period.

Disclosure Requirement 4 - Characteristics of quality of entity-specific disclosures

24 The undertaking shall provide information about how it discloses entity specific material impacts, risks and opportunities.

25 The principle to be followed under this disclosure requirement is to account for the need for the undertaking to develop appropriate disclosures for all entity specific material sustainability impacts, risks and opportunities.

26 Disclosing appropriately at entity-specific level implies that disclosures meet the characteristics of quality expected from sustainability information which can be summarised as follows:

(a) information shall be relevant,

(b) information shall give a faithful representation of the phenomenon it purports to depict,

(c) information shall be comparable to the maximum extent possible,

(d) information shall be verifiable, and

(e) information shall be understandable.

27 When designing its entity-specific disclosures the undertaking shall pay particular attention to the following:

(a) at entity-specific level comparability between undertakings may be limited. However available and relevant references, frameworks, initiatives and benchmarks shall be considered in order to provide elements of comparability to the maximum extent possible,

(b) comparability over time is a key aspect of comparability. As a consequence, consistency of methodologies and disclosures is a key comparability factor and changes in methodologies or disclosures shall be duly explained and justified, and

(c) no aspect of an identified entity-specific material impact, risk or opportunity shall be omitted. This may include disclosing, as applicable, relevant information in relation to strategy, governance, policies, targets, action plans, resources and metrics. In this regard guidance can be found in a comparison with information required under ESRS addressing similar sustainability matters. Disclosures shall follow, when applicable, the definitions mandated by ESRS 5.

28 The undertaking shall scrutinise the capacity of any metric or indicator to provide valuable insight to the users of reporting. These criteria, directly related to the characteristics of relevance, faithful representation, comparability or reliability/verifiability, include:

(a) information shall not have unintended consequences in practices or interpretation of the information,

(b) information concerning measures shall have an indicative capability of the likelihood that the company’s practices are reducing negative outcomes and increasing positive outcomes for people and the environment,

(c) In the case of quantitative metrics, whether the issue at hand can reasonably be measured by a company without an excessive amount of conjecture and unknowns that would render it too arbitrary to be of value, and

(d) contextualisation: the extent to which an indicator can be relied upon for insight absent contextual information to enable its interpretation; and the extent to which variations in such contextual information mean that a quantitative indicator does not provide for comparability.

29 The dsclosure required by paragraph 24 shall include the following information:

(a) an acknowledgement of the characteristics of quality used by the undertaking as reference to define the disclosures related to entity-specific material impacts, risks and opportunities

(b) a description of specific steps, if any, taken to define the disclosures in addition to the processes described under Disclosure Requirement 1 above, and

(c) a description of significant changes in (a) and / or (b) as compared to the previous reporting period.

Application provisions

30 The content of ESRS corresponds to the sustainability reporting architecture defined by the CSRD which establishes the sustainability matters to address. The way sustainability matters are addressed is expected to evolve as ESRS develop. In this context the need for entity-specific disclosures is likely to evolve as the coverage of sustainability matters by mandatory sector-agnostic and sector-specific disclosure requirements expands.

31 As a consequence of the above, the undertaking is allowed to adopt transitional measures for the first (….) reporting periods by which it shall as a priority when defining its entity-specific disclosures:

(a) introduce in its reporting entity-specific disclosures (i) that have been reported on by the undertaking in prior periods (ii) as long as these disclosures meet or are adapted to meet the characteristics of quality referred to under Disclosure Requirement 4,

(b) consider the facts and circumstances that are unique to its activities and business model(s) and therefore likely to drive the medium- and long-term need for entity specific disclosures, and

(c) in addition, consider the available best practices and/or frameworks to complement, in an appropriate manner, its sustainability reporting with a reasonable set of well prioritised disclosures additional to the ones covered by ESRS.

Appendix A: Defined terms

This appendix is an integral part of the [draft] ESRS 4 *Material dustainability impacts, risks and opportunities*.

Comparability in relation to quality, is about the ability to relate sustainability information to a given point of reference or to the same information provided in previous reporting periods. A point of reference can be a target, a baseline, an industry benchmark, comparable information from other entities, from a planetary or social boundary foundation, etc.

Double materiality perspective refers to a perspective in which the risks and opportunities to the undertaking (financial materiality) and the impacts of the undertaking (impact materiality) each represent one materiality perspective. It requires information to the extent necessary for an understanding of the undertaking's development, performance, position and of the impact of its activities on environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

Due diligence process to identify, prevent, mitigate, and account for how the undertaking addresses its actual and potential negative impacts

Faithful representation in relation to quality is about whether sustainability information conveys complete, neutral and accurate the reality it tries to depict.

Financial materiality in the context of sustainability reporting is a characteristic of a sustainability topic or information in relation to an undertaking, a particular sector or all sectors. A sustainability topic is material from a financial perspective if it triggers financial effects on undertakings, i.e. generates risks or opportunities that are likely to influence the future cash flows and therefore the enterprise value of the undertakings in the short, medium or long term but are not captured by financial reporting at the reporting date. These risks and opportunities may have effects on future cash flows in relation (i) to assets and liabilities already recognised in financial reporting as a result of past events or assets and liabilities that may be recognised as a result of future events or (ii) to factors of enterprise value creation that do not meet the accounting definition of assets (liabilities) and/or the related recognition criteria but contribute to the creation/maintenance of enterprise value. The latter are generally defined as "capitals" in frameworks promoting a multi-capital approach.

Triggers of financial effect may be attributed to two groups (i) they may influence the undertaking's ability to continue to use the resources needed in its productive process; (ii) they may affect the undertaking's ability to rely on relationships needed in its productive processes in the same terms as presently done.

Impacts effect the undertaking has or could have on the economy, environment, and people, including on their human rights, which in turn can indicate its contribution (negative or positive) to sustainable development. Impacts can be actual or potential, negative or positive, short-term or long-term, intended or unintended, and reversible or irreversible.

Impact materiality is a characteristic of a sustainability topic or information in relation to an undertaking, a particular sector or all sectors. A sustainability topic or information is material from an impact perspective if the undertaking is connected to actual or potential significant impacts on people or the environment related to the sustainability topic over the short, medium or long term. This includes impacts directly caused or contributed to by the undertaking and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain.

A negative impact is ‘directly linked to’ the undertaking’s operations, products or services, if it occurs at any tier of business relationships, provided it occurs as part of the value chain. It is not restricted to most obvious links between the organisation and the other undertaking, and is therefore not limited for instance to direct contractual relationships, such as ""direct sourcing”.

The significance of an actual negative impact is determined by the severity of the impact (scale, scope, and irremediable character), while the significance of a potential negative impact is determined by the severity and likelihood of the impact. In the case of potential negative human rights impacts, the severity of the impact takes precedence over its likelihood.

Quality information

Is information that is relevant, gives a faithful representation of the phenomenon it purports to depict, is comparable to the maximum extent possible, verifiable, and understandable meets the characteristics of quality of information.

Opportunities

Sustainability-related financial opportunities are uncertain environmental, social or governance events or conditions that, if they occur, could cause a potential material positive effect on the undertaking’s business model, strategy and sustainability strategy, its capability to achieve its goals and targets and to create value, and therefore may influence its decisions and those of its business relationships as regard to sustainability matters.

Like any other opportunity, sustainability-related financial opportunities are the combination of a probability of occurrence, and an impact magnitude.

Rebuttable presumption of mandatory disclosure requirements

Mandatory disclosure requirements are considered material for an undertaking until proven untrue (rebutted). The rebuttable presumption places the responsibility of proof (i.e., that a disclosure requirement is not material) on the undertaking.

Relevance

In relation to quality is about information that has substantive influence on the assessments and decisions of users of reporting under a double materiality approach.

Risks

Sustainability-related financial risks are uncertain environmental, social or governance events or conditions that, if they occur, could cause a potential material negative effect on the undertaking’s business model, strategy and sustainability strategy, its capability to achieve its goals and targets and to create value, and therefore may influence its decisions and those of its business relationships as regard to sustainability matters.

The risk management framework implemented by the undertaking aims at the identification, measurement, prevention and mitigation of sustainability-related financial risks.

Like any other risks, sustainability-related financial risks are the combination of a probability of occurrence, and an impact magnitude.

Severity of a negative impact

is determined by the following characteristics (i) Scale: how grave the impact is, scope: how widespread the impact is, and its irremediable character: how hard it is to counteract or make good the resulting harm.

Understandability in relation to quality is about information that enables all (knowledgeable) intended users to readily identify the main points being made in a straight-forward manner. This includes a clear, logical layout and easy to follow presentation of the information in a way that effectively outlines and draws attention to material aspects under the double materiality approach.

Verifiability In relation to quality is about information enabling users to trust the information in their decisions and it being auditable when required. It is about ensuring reliability of the presented information and of the process that has led to that information. Reliability is when different independent observers with reasonable expertise would be in a position to reach a similar conclusion and consider that a particular disclosure conveys a faithful representation.

Appendix B: Application Guidance

This appendix is an integral part of the [draft] ESRS 4 Material sustainability impacts, risks and opportunities. It describes the application of the requirements set in paragraphs 1 to 31 and has the same authority as the other parts of the [draft] standard. The provisions set under paragraphs 1 to 31 and under paragraphs AG 1 to AG 7 of this Application Guidance below are cumulative.

For presentation purposes the disclosures can be combined as appropriate for the preparer. In particular, disclosures 2, 3 and 4 may be combined, especially for smaller undertakings.

Disclosure Requirement 1 - Description of the process to identify material sustainability impacts, risks and opportunities

AG 1. The undertaking shall report the processes carried out to assess what disclosures to include in its management report that constitute its sustainability reporting in accordance with the provisions of the CSRD (ref. to CSRD paragraph 19a).

AG 2. These processes shall ensure (i) that the undertaking is complying with all disclosure requirements mandated by ESRS and (ii) that the undertaking has considered all additional entity-specific disclosures necessary to reflect faithfully its impacts, risks and opportunities. (i) and (ii) are of equal importance under a holistic approach of impacts, risks and opportunities related to the undertaking's activities. Such a holistic approach is generally performed on a sustainability matter-by-sustainability matter basis in order to ensure a full coverage of impacts, risks and opportunities.

AG 3. The acknowledgement required by paragraph 7 and related to the way double materiality is adopted for the performance of the undertaking's assessment of impacts, risks and opportunities and fully embedded in its approach, methodologies and processes shall clarify that undertakings consider each materiality perspective in its own right, and disclose information that is material from both perspectives as well as information that is material only from one perspective. The acknowledgement should be an overall statement that the undertaking follows double materiality as an overarching principle in determining its material sustainability impacts, risks and opportunities. It should make an appropriate link between the double materiality principle and the organisation put in place for the assessment as well as the resources dedicated to it, the methodologies adopted and the processes implemented, including the involvement of stakeholders and experts.

AG 4. The description of the organisation put in place and the resources dedicated to the assessment as required by paragraph 9 (a) shall include:

(a) who is conducting the sustainability impact, risk and opportunity assessment, and

(b) who finally decides and is responsible for the results and conclusions of the assessment.

AG 5. The undertaking shall give a description of the methodologies adopted and of the processes implemented for the assessment of material sustainability impacts, risks and opportunities as required by paragraph 9 (b).

AG 6. In describing the methodology mentioned in paragraph AG 5 to determine impact materiality the undertaking shall consider in particular the following aspects:

(a) the undertaking's context on its impacts, risks and opportunities, including its:

(i) activities,

(ii) business relationships,

(iii) sustainability context, and

(iv) stakeholders,

(a) the identification of actual and potential impacts, through:

(i) engaging with relevant stakeholders and experts,

(ii) identifying negative impacts, and

(iii) identifying positive impacts,

(b) the assessment of material impacts, through:

(i) assessing the materiality of negative impacts by their

1. severity and
2. likelihood,

(ii) assessing the materiality of positive impacts by their

3. scale and scope,
4. likelihood.

(c) the impacts, risks and opportunities that, due to their importance to the undertaking, are prioritised and monitored directly by the undertaking's highest governing bodies.

AG 7. whereby the severity of an actual or potential negative impact is determined by the following characteristics:

(a) scale: how grave the impact is,

(b) scope: how widespread the impact is, and

(c) irremediable character: how hard it is to counteract or make good the resulting harm.

AG 8. In describing the methodology mentioned in AG 5 to determine financial materiality the undertaking shall consider in particular the following aspects:

(a) the existence of triggers of financial effects,

(b) the materiality of these triggers, and

(c) the classification of material triggers as risks (contributing to decrease in future cash inflows or increase in future cash outflows and/or decrease in capitals not recognised in financial statements) or opportunities (contributing to increase in future cash inflows or decrease in future cash outflows and/or increase in capitals not recognised in financial statements).

AG 9. The overview required by paragraph 9 (b)i of the due diligence process used to identify potential and actual impacts as material shall describe:

(a) how it is done including information regarding (i) the review of the undertaking's own activities and its business relationships and (ii) the assessment of the context in which it operates,

(b) how scientific and analytical research on impacts on sustainability matters has been taken into account,

(c) how the undertaking assessed both impacts it may cause or contribute to through its own actions and decisions, and impacts that may be directly linked to its operations, products, or services by business relationships, whereby a negative impact is 'directly linked to' the undertaking's operations, products or services, if it occurs at any tier of business relationships, provided it occurs as part of the value chain, and it is not restricted to most obvious links between the organisation and the other entity, and is therefore not limited for instance to direct contractual relationships, such as 'direct sourcing',

(d) the scope it has defined when identifying the impacts, for example, whether it has identified short-term as well as long-term impacts, and

(e) any limitations or exclusions, for example, whether it has excluded business relationships from certain parts of its value chain when identifying the impacts,

and the overview required by paragraph 9 (b)-i of the process used to identify sustainability risks and opportunities that affect or may affect its financial development, performance and position should include information regarding the assessment whether the undertaking will be able to continue to:

(a) use the resources needed in its business processes, and

(b) rely on relationships needed in its business processes in the same terms as presently done or whether the undertaking's practices may trigger an adverse reaction.

AG 10. The explanation required by paragraph 9 (b)-ii of how the undertaking has determined which identified potential or actual impacts on economy, environment and people connected with the undertaking are material shall include information on:

(a) how it has prioritized the material potential and actual, negative impacts on the environment and people identified through its due diligence processes,

(b) how the prioritisation of negative impacts reflects their relative severity and likelihood, where severity is defined by their scale, scope and remediability,

(c) how it has prioritized its material potential and actual positive impacts on the environment and people, and

(d) how the prioritisation of positive impacts reflects their relative scale (how positive/beneficial they are for people or the environment) and scope (how widespread the benefits are),

and the explanation required by paragraph 9 (b)(ii) of how the undertaking has determined which sustainability related financial risks and opportunities are material shall include information on the contribution of those risks and opportunities to decrease or increase the undertaking's future cash flows derived from:

(a) scenarios/forecasts that are deemed likely to materialise, and

(b) those below ‘more likely than not’ threshold but still significant:

(i) tracking of emergence of potential situations related to sustainability matters that following the occurrence of future events may affect cash flow generation potential,

(ii) identification of capitals that are not recognised as assets from an accounting and financial reporting perspective but have significant influence on financial performance, such as natural, intellectual (organisational), human, social and relationship capitals, and

(iii) tracking of possible future events that may have an influence on the evolution of such capitals.

AG 11. The explanation as required by paragraph 9 (c) about the involvement of, and the engagement with (i) stakeholders as well as (ii) internal and external experts shall include:

(a) whether and how the undertaking has engaged with stakeholders to understand the ways in which they may be impacted and who these stakeholders are, and

(b) whether and how it has engaged with internal and external experts and who these experts are.

Disclosure Requirement 2 - Outcome of the undertaking’s assessment on material sustainability impacts, risks and opportunities as identified by reference to and in compliance with sector-agnostic and sector-specific level ESRS

AG 12. From a general standpoint, this requirement facilitates, in particular through disclosure 18 (a), the undertaking providing users of reports with an overall conclusion on its material impacts, risks and opportunities, i.e. on to what extent it is similar and to what extent it is different from all other undertakings or all undertakings in the same sector. Disclosure requirements mandated by ESRS for all undertakings (or for all undertakings in a particular sector) are based on a double materiality assessment that is performed generally observing a standard setting due process, and is subject to a periodical revision. The actual situation, circumstances and context of each undertaking may be different and therefore result into an assessment conclusion putting the emphasis on those sustainability matters identified by each ESRS that are material for the undertaking (for instance climate change, workforce working conditions, etc.).

AG 13. This standard makes a distinction between sector-agnostic and sector-specific ESRS as well as entity specific topics. Sustainability-related impacts, risks and opportunities as identified by sector-agnostic or sector-specific level ESRS are governed by this Disclosure Requirement while additional material sustainability impacts, risks and opportunities that are entity specific are governed by Disclosure Requirements 3 and 4.

AG 14. Starting from the mandatory disclosures required following sector-agnostic and sector-specific ESRS which are presumed to be material for all undertakings or for all undertakings in a sector the undertaking shall assess topic by topic whether they are material given the undertaking’s specific facts and circumstances. Unless a topic is immaterial as a whole the assessment shall then be performed at disclosure requirement level and, for disclosure requirements with multiple disclosures, at granular disclosure level. The outcome of the assessment depends on whether a topic, a disclosure requirement or a disclosure is material or not from the double materiality perspective for an undertaking. Due consideration should also be given whether additional material entity-specific sustainability impacts, risks and opportunities exist in order for them to be addressed under Disclosure Requirement 3 and 4.

AG 15. The result of this assessment shall enable the undertaking to draw conclusions as to which:

(a) mandatory disclosure requirements or granular disclosures are material for the undertaking and are to be disclosed completely (full disclosure), and

(b) mandatory disclosure requirements or granular disclosures are not material for the undertaking and therefore are to be disclosed with an appropriate explanation (disclosure as "not material for the undertaking").

AG 16. The mandatory disclosure requirements are considered material for an undertaking until proven untrue (rebutted). The rebuttable presumption places the responsibility of proof (i.e. that a disclosure requirement is not material) on the undertaking. The assessment whether a mandatory disclosure is material or not for the undertaking shall consider the fundamental aspects of double materiality, as described under paragraph 8 (a) to (h). The undertaking should explain the reasoning leading to the assessment that mandatory disclosure requirements belong to a "not material for the undertaking" category. This may be done for example by describing how, to what extent and in what aspects the undertaking is different from other undertakings in reference to the particular sustainability topic. The fact that a particular topic falls in the "not material for the undertaking" category does not exempt it from reporting disclosures for this topic. The undertaking shall include under this category two situations:

(a) disclosure that are effectively nil, or
(b) disclosure that are not meaningful and decision-useful for stakeholders without being nil.

The undertaking shall give a justification and appropriate evidence that the undertaking is not involved with the negative impacts through its activities or as a result of its business relationships; or that the relative severity and likelihood of the impacts does not meet a threshold of impact materiality.

AG 17. The disclosure requirement on changes to the list of material sustainability topics compared to the previous period as required by paragraph 18 (d) shall explain why a topic that is determined as material in the previous period is no longer considered material or why a new topic has been determined as material for the current period and not the previous.

Disclosure Requirement 3 - Outcome of the undertaking's assessment of material sustainability impacts, risks and opportunities that are not covered by an ESRS (entity-specific level)

AG 18. Relevant disclosures might be missing when (i) ESRS have considered that relevant disclosures should be subject to the reporting undertaking's assessment of their materiality based on the undertaking's specific facts and circumstances or (ii) ESRS might cover a material impact, risk or opportunity and establish mandatory disclosure requirements, but given the specific facts and circumstances of the undertaking they might not consider all aspects or they might not be granular enough. In those cases, entity-specific disclosures are needed and to be developed by the undertaking.

AG 19. The disclosure on entity-specific material sustainability impacts, risks and opportunities including topics that are not yet covered shall be sufficiently detailed to enable readers to understand:

(a) the actual or potential significant impact on people or the environment related to the sustainability topic over the short, medium or long-term including the impact directly caused or contributed to by the undertaking and impacts which are otherwise directly linked to the undertaking's upstream and downstream value chain, as well as
(b) why risks or opportunities are likely to influence the future cash flows and therefore the enterprise value of the undertakings in the short, medium or long term but are not captured by financial reporting at the reporting date.

Disclosure Requirement 4 - Characteristics of quality of entity-specific disclosures

AG 20. When designing its entity-specific disclosures the undertaking shall take into account the characteristics of quality that ensure disclosures provide decisions-useful information for stakeholders and therefore comply with the fundamental qualities of information (relevance and faithful representation) as well as with the enhancing characteristics of quality of information (comparability, verifiability, and understandability) as defined below.

AG 21. The undertaking shall:

(a) relate each entity-specific disclosure to its specific facts and circumstances that are the source of impact, risk or opportunity,

(b) justify that the disclosure is complying with the characteristics of information quality and is therefore providing appropriate information for stakeholders.

Relevance

AG 22. Sustainability information is relevant when it has substantive influence on the assessments and decisions of users of reporting under a double materiality approach.

AG 23. Sustainability information is capable of making a difference in decisions made by stakeholders if it has predictive value, confirmatory value or both.

AG 24. Information has predictive value when it is valuable input allowing stakeholders to form a view on and assess future outcomes. Information has confirmatory value when it provides valuable feedback about the quality of previously reported information. The predictive value and confirmatory value of information are interrelated since one piece of information may have both.

AG 25. A disclosure is relevant if the information is open, transparent and clear in the communication about material sustainability matters as a result of the double materiality assessment.

AG 26. Information related to deliberate selection, contextualisation and weight of information should be considered.

AG 27. As relevance level varies according to assessments in situations of uncertainty, the nature and magnitude of uncertainties should be clearly communicated.

AG 28. The undertaking should assess the extent to which a required disclosure is capable of providing insight that is decision-useful for stakeholders that are users of sustainability reporting, whether from the perspective of material impacts on people and the environment, or from the perspective of the financial materiality, or both.

AG 29. Materiality is an enabling factor of relevance. From the perspective of impacts on people and the environment, the assessment by the undertaking should reflect that the materiality of sustainability matters derives from an assessment of the relative severity of those impacts (and scale and scope for positive impacts). Recognising that users of sustainability reporting represent diverse interests across the full range of sustainability matters, it is the focus on these most severe impacts that helps ensure the relevance of information to users' assessments and decisions, under the impact materiality perspective. From the perspective of financial materiality, the assessment by the undertaking should reflect that, beyond information already available in financial reporting, the materiality of sustainability matters derives from an assessment of the likely effects of those matters on future cash flows and therefore on value creation. The link between sustainability matters and effects on cash flows requires specific attention in relation to level of likelihood, the possible timeline and the nature of the effect.

Faithful representation

AG 30. Sustainability information should convey a faithful representation of the reality it depicts.

AG 31. The undertaking when specifying characteristics of quality in circumstances where undertakings are required to define entity-specific material disclosures needs to:

(a) Define the scope and objective of the disclosure, i.e. the reality it intends to cover so that the information to be reported corresponds to its stated purpose.

(b) Make sure that, within the defined scope, disclosures meet the three characteristics of: (i) completeness; (ii) neutrality; and, (iii) accuracy

AG 32. A complete depiction includes all material aspects related to the reportable content, including appropriate descriptions and explanations. Users shall be able to make informed decisions by having access to all necessary information, which shall not omit relevant aspects, factors or topics within the defined reporting boundary.

AG 33. A neutral depiction is without bias in its selection and/or presentation of sustainability information. It should be balanced, so as to cover favourable/positive and unfavourable/negative aspects. The undertaking should in particular avoid focusing exclusively or primarily on negative externalities: from an impact materiality perspective, negative and positive material impacts should receive equal attention. From a financial materiality perspective, risks and opportunities should be considered on an equal footing. Overstatement or understatement of risks, opportunities and impacts are to be avoided.

AG 34. Neutrality is supported by the exercise of prudence which implies the exercise of caution and clarity on assumptions when making judgements under conditions of uncertainty or in relation to forward looking information. When sustainability-related information results from management judgements (for instance targets and plans), specific information on the context of, and conditions for, these decisions is generally useful. When judgement is exercised in the context of high uncertainty which affects estimates or outcomes, particular attention should be paid to prudence with appropriate reference, when relevant, to the provisions of the Accounting Directive (Directive 2013/34/EU) and the International Accounting Standards Regulation (EC) No 1606/2002.

AG 35. Information shall a priori not be netted or compensated: information would not be neutral if it could mislead users because for example the positive aspects have been eliminated or offset by negative aspects. When the undertaking proposes to net information, proper explanation has to be provided.

AG 36. An accurate information implies that the underlying processes and internal control to reduce errors or material misstatements is operational. Estimates should be presented as such with a clear emphasis on possible limitations.

AG 37. Information can be accurate even if not perfectly precise as long as the disclosure reflects properly the sustainability matter it purports to address.

AG 38. Design of sustainable disclosures requirement should allow to obtain accurate information and due consideration should be given in particular to accuracy of factual information, precision of descriptions, processes and checks and balances supporting information reflecting judgement.

Comparability

AG 39. Sustainability information should be presented on a basis that is consistent over time and, to the greatest extent possible, in a way that enables comparisons between undertakings (across sectors and within a specific sector).

AG 40. Comparability in relation to quality is about the ability to relate information to a given point of reference or to the same information provided in previous reporting periods. A point of reference can be a target, a baseline, an industry benchmark, comparable information from other entities, from a planetary or social boundary foundation, etc.

AG 41. Comparability over time requires consistent reporting. Consistency refers to the use of the same approaches or methods for the same sustainability matter, from period to period by a undertaking (as well as by other undertakings to the maximum extent possible). Accordingly, reporting options, metrics used and disclosures reported should remain stable; any change from one year to another should be explained and is expected to occur only when the new reporting policy allows to provide more useful information. When a change in reporting policy (approach, method, option, metrics used to report and disclosures reported) occurs, the data related to the comparative period should be restated according to the new policy and disclosed together with the description of the methodology used for the restatement. Metrics to be used should be based on generally accepted international standards and with their corresponding units as defined.

AG 42. For certain quantitative information, the establishment of a baseline year can be useful. If not set by a generally accepted practise, a baseline year should be set by the undertaking itself. The baseline year should be fixed and only changed according to foster a better understanding of the depicted phenomenon in relation to retrospective and prospective evolution.

AG 43. Relative data can be a very useful supplement for users of reporting. However, in order to promote comparability, reporting of absolute data should be prioritised as well as normalised data.

AG 44. As users need to compare information between various undertakings, comparability between reporting entities assumes that entities facing the same fact pattern will prepare information and report in a similar way, allowing for proper comparison.

Verifiability

AG 45. Sustainability information is verifiable if it enables users to trust the information in their decisions and it can be audited when required.

AG 46. Verifiability is about ensuring reliability of the presented information and of the process that has led to that information. Reliability is when different independent observers with reasonable expertise would be in a position to reach a similar conclusion and consider that a particular disclosure conveys a faithful representation. Information is verifiable if it is possible to trace it.

AG 47. Verifiability is the prerequisite of the sustainability reporting being auditable, because it allows for appropriate evidence to be obtained as to the audit assertions (based on the required level of assurance).

AG 48. The undertaking has the task to implement appropriate procedures, set up internal controls as well as suitable organisation and to assess which part of the report and/or information is ready/mature to allow for its verification.

AG 49. The undertaking has the task of identifying and defining subject matters and where applicable the relevant sector specific criteria in order to ensure that all assumptions, data compilations, methods and caveats (whatever their format) will be sufficiently transparent, documented and traceable for allowing a verification of information.

AG 50. Sustainability disclosures shall be required in a way that allows their verifiability by providing contextual information on underlying assumptions and description of implemented processes and methods.

Understandability

AG 51. Sustainability information should be presented in a clear and concise manner.

AG 52. Understandable information enables all (knowledgeable) intended users to readily identify the main points being made in a straight-forward manner.

AG 53. This includes a clear, logical layout and easy to follow presentation of the information in a way that effectively outlines and draws attention to material aspects under the double materiality approach.

AG 54. For sustainability disclosures to be concise, they need to:

(a) avoid generic information, sometimes called 'boilerplate', that is not specific to the undertaking;

(b) avoid duplication of information, including unnecessary duplication of information also provided in financial statements; and

(c) use clear language and clearly structured sentences and paragraphs.

AG 55. The clearest form of disclosure depends on the nature of the information and might sometimes include tables, graphs or diagrams in addition to narrative text. If graphs or diagrams are used, additional text or tables may be necessary to avoid obscuring material detail.

AG 56. Clarity might be further enhanced by distinguishing information about developments in the reporting period from 'standing' information that remains unchanged, or changes little, from one period to the next – for example, by separately highlighting features of the undertaking's sustainability-related governance and risk management processes that have changed since the previous reporting period.

AG 57. Concise disclosures should include only material information. Any immaterial information included shall be provided in a way that avoids obscuring material information.

AG 58. Some sustainability matters are inherently complex and may be challenging to present in a manner that is easy to understand. The undertaking should seek to present such information as clearly as possible. However, complex information about these matters should not be excluded from reports to make those reports easier to understand. The exclusion of such information would render those reports incomplete and, therefore, possibly misleading.

AG 59. The completeness, clarity and comparability of sustainability disclosure all rely on information being presented as a coherent whole. For sustainability-related disclosures to be coherent, such information shall be presented in a way that explains that context and the relationships between the related pieces of information.

AG 60. Understandable information should always be presented in the right context, balanced as much as possible, consistent within the sustainability reporting itself and with information provided elsewhere in the corporate reporting. The order in which information is presented is important for its ability to be understandable.

AG 61. Some disclosures might be best understood in the context of information in the related financial statements. If sustainability risks and opportunities discussed in financial statements have implications for sustainability reporting, the undertaking shall include the information necessary for users to assess those implications and present connected information (including reconciliations and statements of consistency between financial and sustainability information).

AG 62. The undertaking assesses whether information is material to the sustainability report, regardless of whether such information is also publicly available from another source.

AG 63. The digitisation process shall also be considered to provide for an easy access to the disclosures without undue risks of misinterpretation.

AG 64. For quantitative information, no netting or offsetting should be allowed as such does not contribute, in general, to an understanding of the underlying facts. A gross presentation is a priori a prerequisite for transparency.

AG 65. The level of information, granularity and technicality should be aligned with the needs and expectations of users.

AG 66. The language shall not be unduly technical and the undertaking should use in priority defined terms, as standardised and as recapitulated in the general glossary. If additional qualifications are needed, the undertaking should address them. Such qualifications include: (i) reasonably to be expected efforts to learn about the business or industry from other sources than the sustainability report, and (ii) general insight into issues related to sustainability matters.

AG 67. Abbreviations should be avoided; units of measure should be indicated.

Appendix C: Digitisation guidance

This appendix is an integral part of the [draft] ESRS 4 *Material sustainability impacts, risks and opportunities*. It describes the instructions for the digital tagging of the disclosure requirements in paragraphs [5-31].

[Requirement 1]

DT 1. Text to be added

DT 2. Text to be added

[Requirement 2]

DT 3. Text to be added

DT 4. Text to be added