SEEING DOUBLE

What double materiality means for you

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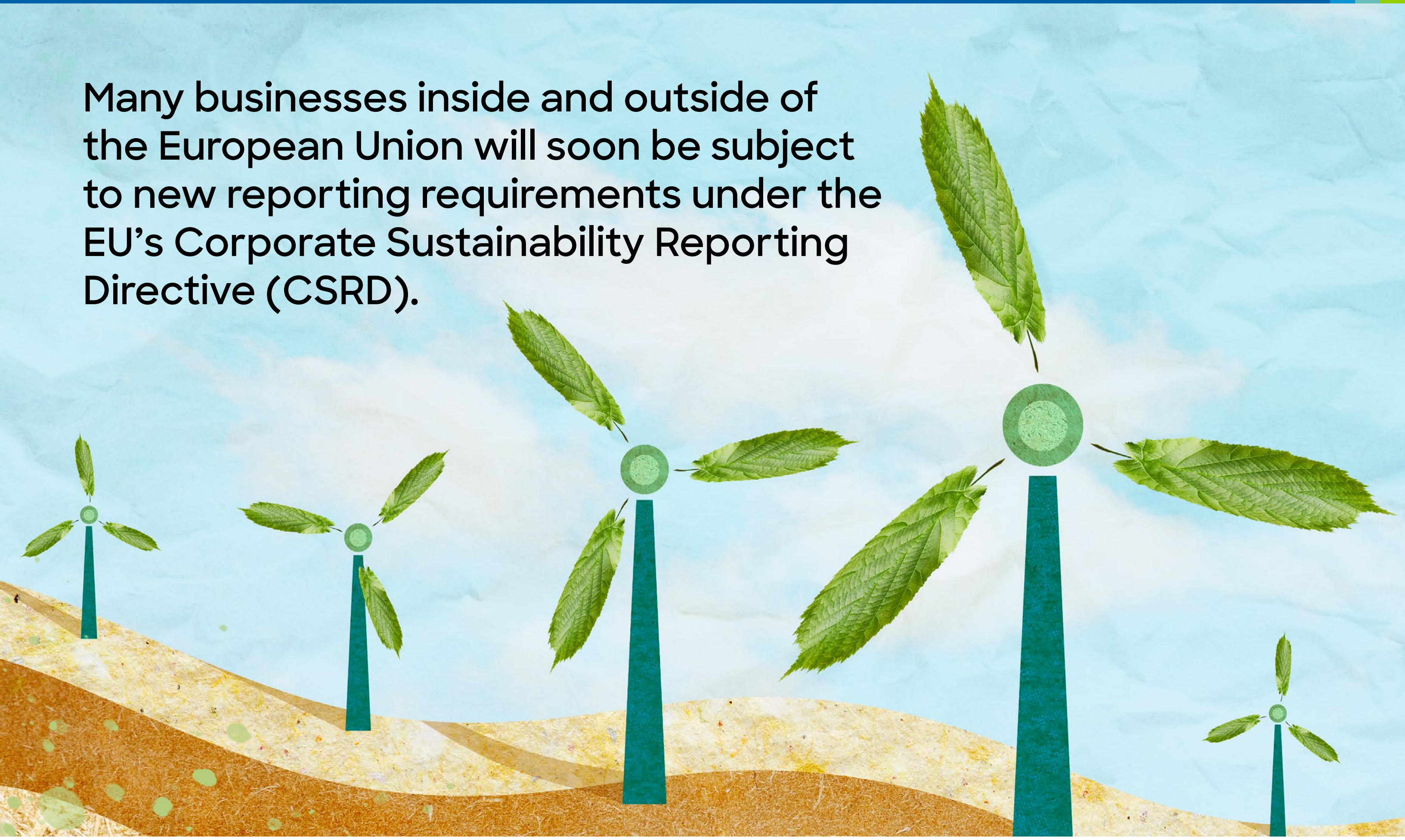
Many businesses inside and outside of the European Union will soon be subject to new reporting requirements under the EU's Corporate Sustainability Reporting Directive (CSRD).



These new standards will require companies to consider a wider range of their impacts, both inside their company and throughout their value chain. If you are keeping up with these regulatory changes, you've likely heard about the CSRD's double materiality standard. But if you're like many environmental, social and governance (ESG) professionals, you may not know how to proceed.

In this paper, we'll explain what a double materiality assessment is, how it differs from past materiality assessments, and how you can move forward.

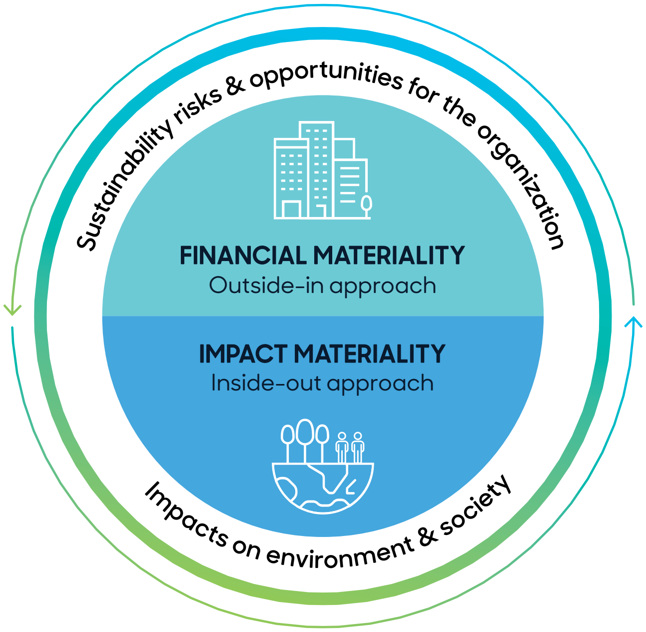
Materiality: What matters most to a business

Before we discuss double materiality, let's level-set by discussing materiality more generally. Materiality assessments are a process for organizations to determine which issues are relevant or significant. The topics that rise to a high level of importance are deemed "material" to the business. This designation is useful because it allows businesses to easily prioritize their areas of risk and opportunity. Material topics are the basis of regulatory disclosure and are intended to provide investors with insight into the potential risks and opportunities facing a company.

Double materiality assessments ask you to consider two different types of material issues: those that are financially material and those that generate material impacts.

Financially material issues are those that affect a company's cash flow, access to capital, cost of capital or other financial performance indicators. This is the traditional conception of materiality used by finance and accounting teams. However, it also can be applied to the sustainability space by asking what sustainability-related topics affect a company's financial results over the short, medium and long term. In essence, financial materiality reflects how the outside world affects a business – sometimes referred to as "outside-in."

Impact materiality, meanwhile, analyzes a company's influence on the environment, economy and society. It focuses on the issues that a company impacts, which in turn affect people, communities or environments outside the company. This type of materiality will be familiar to any company that has published a Global Reporting Initiative (GRI) disclosure. Impact materiality can be summarized as how a business impacts the world – often referred to as "inside-out."



Double materiality considers both of these approaches – outside-in and inside-out – to capture the full sustainability context of a business.

Given that these two conceptions of materiality have existed for some time, why are they coming together now? The CSRD will require that companies conduct a double materiality assessment to identify the sustainability-related topics that must be disclosed. The CSRD is an EU law, but also requires non-EU business that have a large EU presence to disclose sustainability-related information. The timeline for implementation varies based on company characteristics, with large EU companies beginning to disclose in 2025. Listed small and medium EU companies will follow suit in 2027, followed by non-EU companies with a large EU presence in 2029.

While this regulation is creating a driver for companies to act, it also reflects a greater truth: businesses can do more to acknowledge the many ways they impact and are impacted by society and the natural world. In other words, they must internalize their externalities.

In an age of interconnection and globalization, these externalities reach farther than ever before. For example, many companies hadn't considered public health emergencies in their materiality assessments before the COVID-19 pandemic upended their supply chains. Climate change is the ultimate double-material issue, with both outside-in and inside-out implications for nearly every business. While CSRD does not require that companies identify climate change as a material issue, it asks that companies that do not find it to be material explain why.

Setting the threshold for materiality

How do you know when a topic is material? Each company will have to make its own determination on its specific thresholds for impact and financially material issues, but CSRD has issued guidance to help standardize the approach. The standards issued under CSRD suggest assessing issues with a negative material impact based on the severity of the impact as measured by scale, scope, how difficult the impact would be to reverse (also known as irremediability) and the likelihood of negative impact. Potentially positive impacts can be assessed based on scale and scope.

For financially material issues, CSRD guidance suggests using traditional measures of financial impact, such as the likelihood of the occurrence and the financial effect.

A roadmap for double materiality assessment

So, how do you actually conduct a double materiality assessment? CRI's double materiality roadmap builds on the guidance from CSRD, as well as best practice in traditional materiality assessments.

PHASE 1

Landscape assessment

In this initial step, companies must gather the relevant context to understand the sustainability-related expectations for their sector, as well as relevant inputs from peers, previous materiality assessments, regulators and third-party groups.

PHASE 2

Value chain mapping and stakeholder identification

Under CSRD, companies are required to consider the issues that they impact and are impacted by throughout their full value chain – both upstream and downstream. The value chain must be mapped to identify the areas of potential impact. Once these areas are identified, companies can work to identify the stakeholders that experience that impact throughout their value chain.

A value chain map is likely to identify many different impact areas and potential stakeholder groups. Companies must assess these potential stakeholder groups to help prioritize engagement. CRI uses a stakeholder salience approach that helps classify stakeholder groups based on their key characteristics and potential influence on the company.

PHASE 3

Topic identification

With stakeholders identified and mapped to areas of impact, companies can then identify potential topics or issues associated with these impacts. The topics can be positive or negative and should cover not only a company's value chain, but also its own operations. CSRD has identified a list of sustainability-related topics to consider, but companies may need to add additional topics based on their own characteristics.

Additionally, the double materiality process under CSRD requires that businesses consider longer-term impacts by assessing topics over different time horizons. The standards ask that topics be considered over the short, medium and long term, but the specific meaning of those time frames is company-specific and intended to align with business planning.

PHASE 4

Stakeholder engagement

The stakeholder engagement process should be used to enable companies to prioritize their financial and impact material issues. The process may look like a traditional materiality process, with companies engaging core stakeholders through surveys, interviews or focus groups. However, applying the lenses of both financial and impact materiality mean that questions and stakeholder groups may be different than in previous assessments.

Stakeholder engagement processes can vary by company, with some companies choosing to undergo robust stakeholder issue prioritization processes and others using stakeholder engagement to validate prioritization of issues.

PHASE 5

Analysis and integration

CRI recommends leadership engagement early on to ensure process buy-in and to secure leadership validation of assessment results. Many companies may see little change in their final set of material issues compared to previous materiality assessments they have conducted. However, companies just beginning to explore their full value chain or impacts over time are likely to see shifts. For example, those that have not previously considered downstream end-of-life product issues may see the topic of waste grow in importance. The resulting list of prioritized material topics will be used to guide disclosure and inform reporting.

What about the matrix?

Many companies have developed materiality matrices to help visualize the results of their materiality assessments. These matrices are not standardized, and the dimensions often vary by company. While CSRD does not have a visualization requirement, double materiality creates new opportunities to depict your priorities graphically. In a traditional matrix, companies often plot the "importance" of issues. In the case of a double materiality assessment, businesses can plot the potential magnitude of impacts.

While no standard practice has yet emerged, we recommend that you make financial materiality and impact materiality the two axes of your matrix. You can also get creative and incorporate other elements considered as part of your assessment, such as time horizons for impact or the financial effects of sustainability issues.

Preparing for assurance

CSRD will require businesses not only to conduct double materiality assessments, but also to seek assurance. This process is intentionally flexible, to allow companies of different capacity levels to meet the requirement. While current requirements are not overly prescriptive, your assessment should be able to withstand scrutiny by a third-party auditor and include clearly defined and documented steps, identification of consistent definitions, a scoring methodology and a stakeholder engagement methodology.

What's next?

CSRD, as well as other emerging and expected disclosures, are putting new demands on businesses. Now is the time to prepare and begin to understand what this regulation means for you. To avoid a rush near your required disclosure deadline, we suggest starting now by:

- Conducting a scaled-down version of an assessment to become comfortable with the process and find your roadblocks. A consultant like CRI can help.
- Engaging and socializing this concept within your company.
- Conducting a value chain mapping exercise.
- Reviewing previous materiality assessments to identify how much material can be repurposed.
- Preparing GRI disclosures.
- Talking to internal legal, finance and audit teams to engage them on their role in this process and the implications of aligned financial and sustainability reporting.

With new standards and requirements regularly emerging, it may seem like a confusing time for disclosure – but it's also an exciting one. We are at the beginning of the mandatory sustainability reporting journey, and growing pains are part of the process. Additional guidance and structure will emerge over time as disclosures shift from voluntary to mandatory.

This new regulatory approach is emerging at a pivotal time for the ESG space. Many investors and other stakeholders increasingly see ESG issues as relevant to business. At the same time, some players are questioning the importance of ESG factors, while others are calling out less transparent companies for engaging in greenwashing.

While some businesses may treat double materiality as another compliance exercise, we see it as a tool that companies can use to cut through this noise. By measuring both impact and financial implications for each material issue – with a clear methodology to back up their work – companies can help make the case for their priorities, connecting impact areas to business results.

Learn More

We'd love to discuss the concept of double materiality with you further. Contact us here.

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