Double materiality. The guiding principle for sustainability reporting

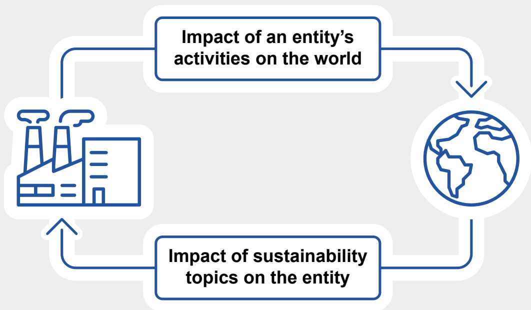
What is the issue?

Societal expectations have grown exponentially around sustainability issues in the last decade, and this has resulted in an increased global push for companies to consider and report both their impacts on the world as well as how sustainability issues impact the financial well-being of the company. The European Union dubbed this concept “Double Materiality”. As a result, a global corporate reporting regime is emerging in which sustainability impact reporting and strengthened financial reporting are mandated on equal footing, as two key perspectives managed with the same rigour:

- Perspective 1 – Reporting on impacts a company is having on society and the environment and hence their contributions towards sustainable development.

- Perspective 2 – Reporting of sustainability-related financial disclosures addressing the financial implications of sustainability issues.

The reality is that the two perspectives are interlinked and that impacts of an organization are or can become financially material over time. Without understanding these impacts, it won’t be possible to get a complete overview of financial risks affecting the company.



The 2023 Annual Global Benchmark Policy Survey[1] conducted by the Institutional Shareholder Services Inc. (ISS) revealed that, when asked how their organization defines *materiality*, 75% of investors responded that materiality assessment should include external company impacts. Only 6% of investors stated that materiality assessments should be limited to factors having a direct financial impact on the company.

Moreover, impact reporting is also highly relevant in its own right as a public interest activity for multiple stakeholders. The impacts of a company matter, and must be reported even if the company or its investors do not consider them to be financially material, either now or in the future.

What does this mean for policy makers?

Policy makers must be aware that double materiality is more than a theoretical concept. It is appearing in policies and regulations, for example, as a fundamental bedrock of the Corporate Sustainability Reporting Directive (CSRD) which entered into force in January 2023. CSRD shifted sustainability reporting in Europe from the ‘nice to have’ to the mandatory sphere, making it obligatory for companies in the EU to report on the

1 In total, ISS received 455 responses to this year’s benchmark policy survey. There were 239 responses from institutional investors and investor-affiliated organizations, and 216 responses from companies, corporate-affiliated organizations, and other non-investor respondents.

impact of corporate activities on the environment and people as well as how these impacts influence the financial position of the company.

While it is not universally true that where the European Commission (EC) leads, others will follow, the integration of double materiality into the CSRD means national policy makers in the EU must develop policies aligned with double materiality, while outside the EU they will be confronted with it.

It is not only within CSRD that double materiality as a concept is reflected. For example the EU's Corporate Sustainability Due Diligence Directive (CSDDD) is a proposed directive which obliges companies to demonstrate what action they are taking to protect the environment and human rights. It could result in liabilities for companies who do not adequately manage these impacts. Regulation on deforestation-free products and Regulation on battery and waste batteries will trigger such liabilities in cases of ecosystem conversion, biodiversity loss and human right abuses. Therefore, the number of issues that can have a financial impact on the company and influence investor decision-making is constantly increasing.

How can GRI help?

GRI supports the concept of double materiality, and its standards represents the impact side of double materiality. In terms of the other perspective of double materiality, reporting sustainability-related financial disclosures, companies that produce a GRI report are well prepared for double materiality because of a "sequencing" effect: the reported impacts serve as the basis for companies to determine which of these impacts, at what point in time could affect the financial health and value creation of the company.

In this respect, GRI's collaboration with the IFRS Foundation is important because it means their respective standard setting boards, the Global Sustainability Standards Board (GSSB) and the International Sustainability Standards Board (ISSB), will coordinate their capacity building programs and standard-setting activities, ensuring a high degree of interoperability between the two leading impact and financial reporting standards.

Leveraging GRI as a baseline to this holistic approach is a good practice. The GRI standards address a wide array of sustainability topics that extend beyond climate-related matters. They are used by 73% of the world's 250 largest companies by revenue, according to KPMG. GRI offers the only reporting standards used by most surveyed companies in all regions (75% in the Americas, 68% in Asia-Pacific and Europe, 62% in ME & Africa).

Moreover, GRI Standards are developed by a broad group of stakeholders (NGOs, business, workers, think tanks, academia, and investors), experts on a specific issue or sector in question. They integrate international norms and guidelines, such as the United Nations Guiding Principles on Business and Human Rights (UNGPs), and the Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises. In the context of a global business, complying with local laws only may not be enough. Relying on standards that are based on international conventions can therefore safeguard a company from risks of violating international norms.

GRI standards also integrate with existing mandatory reporting frameworks. GRI and the European Financial Reporting Advisory Group (EFRAG) the body which developed the European Sustainability Reporting Standards (ESRS), are collaborating to make sustainability reporting easy to comply with. The high level of interoperability between ESRS and GRI standards in relation to impact reporting was confirmed in a recent MoU and the release of a joint interoperability index.

Double materiality, in essence, reflects the new practical nature of sustainability reporting and the recognition that impact, and financial reporting are interconnected and that reporting ideally should be one holistic process. For more information on taking this approach, please contact policy@globalreporting.org.

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