

DOUBLE MATERIALITY: KEY TAKEAWAYS FROM THE HIGH-LEVEL POLICY DIALOGUE

Tuesday 29 June 2021

On 29 June, GRI convened a multi-stakeholder dialogue to foster a common understanding on the inclusion of the concept of double materiality in the European Commission's Corporate Sustainability Reporting Directive (CSRD) legislative process.

High-level speakers from a wide range of stakeholder groups exchanged views and perspectives on the inclusion of the concept of double materiality in the CSRD, if it is fit-for-purpose to help achieve the required transparency on sustainable development impacts for all stakeholder groups, and how it influences global thinking.

In this document you will find the key takeaways from the dialogue.

Financial and sustainability reporting should be mandated on equal footing

These should be looked at as two key perspectives interconnected by their respective underlying standard-setting mechanisms and managed with the same rigor.

Each 'direction' of the notion of double materiality should be considered in its own right, and it is not about the convergence of the two perspectives that renders an issue as material. Impacts on society and the environment cannot be deprioritized on the basis that they are not financially material or vice versa. Both types of reporting have an essential role to play and must co-exist in a dedicated process of inter-connectivity to build the bridge between sustainability reporting and financial reporting.

To understand risks, you need to understand impacts

Companies need to understand their impacts on the world before they can understand the impacts on the company, including the associated (financial) risks. Workers interests are business interests and therefore investor interests, so there should be a broader dimension of accountability towards stakeholders. The relationship between risks and impacts may be less important to some but essential to others, and the impact can be more or less acute depending on the topic.

Investors are becoming increasingly aware of environmental, social and governance (ESG) related risks and impacts and are assessing the capabilities of companies to manage those, which can therefore impact the value of a company. The longer the investment horizon of the investors, the more important this understanding becomes. Good reporting is therefore crucial for assessing and benchmarking their performance.

Financial reporting should account for risks related to sustainability impacts

The traditional scope of financial reporting should be expanded to account for risks related to the impacts to the environment/society from an organizations' activities.

The impacts of sustainability and non-financial risks can be challenging to determine. Potentially significant risks cannot easily be differentiated between those that do and those that don't affect enterprise value and estimating financial consequences of sustainability impacts is challenging and can lead to undesirable changes in behavior. Sometimes there is a need to report on topics not yet requested by stakeholders for risk and impact management purposes.

Short, medium and long term horizons should be taken into account

Different impacts and risks can be identified depending on the time horizon considered. The lens that double materiality provides is essential for evaluation of how to take appropriate action and respond to change. The landscape of financial and non-financial issues is constantly evolving, and there are challenges in predicting certain unexpected risks and impacts, such as extreme rainfall or wildfires. Impact is also influenced by whether the risks are reversible or irreversible, and it is in the nature of these issues to change and evolve over time.

Greater convergence is needed in policy

There should be consistency of laws and regulation at the European level and progress is urgently needed for further convergence globally. Decisions should be taken about how impacts are regulated and markets should not be fragmented.

Changes to the governance of the European Financial Reporting Advisory Group (EFRAG) and the *recommendations of the EFRAG Task Force* provide the basis for a co-construction approach between the European and international levels. Furthermore, large companies and SME's need a framework that benefits them with a more proportionate approach. Financial reporting standards should also be evaluated to ensure that they capture sustainability risks.

The co-existence of financial and sustainability reporting provides an ongoing mechanism for horizon scanning and for new issues to be identified and carried across into the standard setting process over time. The discussion outcomes above are supported by academic research, a summary of which can be found in the White Paper on *The double-materiality concept: application and issues*.

Statement of Cooperation signed by GRI and EFRAG

Shortly after the event EFRAG and GRI were proud to announce the signing of a Statement of Cooperation which sees both organizations agree to share technical expertise to co-construct new EU sustainability reporting standards and contribute to further global convergence. This collaboration aims to assist the European Commission in fulfilling its objective to increase corporate transparency in support of the European Green Deal.



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