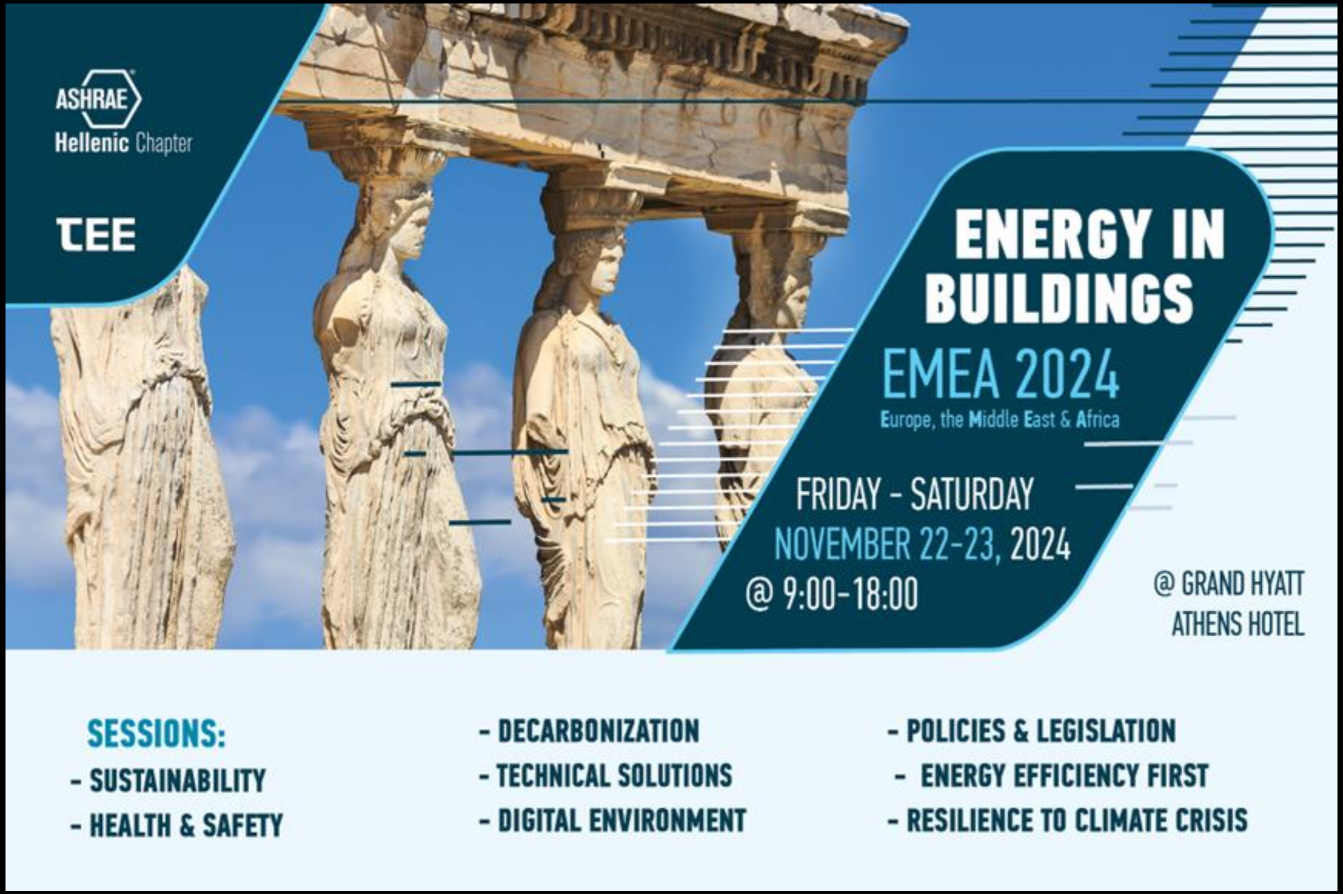
Connecting the dots from SDGs to enterprise-level sustainability & ESG:

A double materiality necessity

Energy in Buildings
Athens Conference 2024



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Intro

On July 31st, 2023:
the European Commission adopted a delegated regulation on the European Sustainability Reporting Standards that detail the requirements for companies within the scope of the E.U. Corporate Sustainability Reporting Directive (EU) 2022/2464 (CSRD)

- ✓ **CSRD and ESRS introduce a "double materiality" model that comprises of impact materiality & financial materiality**

- ✓ **To evaluate materiality under the CSRD, organizations should identify information about material Impacts, Risks, and Opportunities (IROs) connected to their business activities and related sustainability issues**

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ESRS
The European Sustainability Reporting Standards (ESRS) framework for CSRD compliance is the basis for organizations to communicate their sustainability initiatives & impacts

Double Materiality explained

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Under CSRD framework:

Organizations should disclose information that is material from

- ✓ **either an impact perspective**
- ✓ **or a financial perspective**
- ✓ **or from both perspectives**

Sustainability issues with materiality from an impact or financial perspective, or both, relate to material IROs (Impacts, Risks, and Opportunities)

As depicted in ESRS 1:

Impacts

"[P]ositive and negative sustainability-related impacts that are connected with the undertaking's business, as identified through an impact materiality assessment" (paragraph 14(a))

Risks and opportunities

An "undertaking's sustainability-related financial risks and opportunities, including those deriving from dependencies on natural, human and social resources, as identified through a financial materiality assessment" (paragraph 14(b))

4 dots to connect with examples

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Before we start to connect the dots & design the process:

- ➢ **Your organization should be in compliance with the standards (in principle)**

but

- ➢ **Check on your organization's specifics so, to modify**

- ➢ **Design by processing:**
- ✓ **IG 1: Materiality Assessment Implementation Guidance**

https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets/IG%201%20Materiality%20Assessment_final.pdf

- ✓ **Implementation guidance related to the ESRS.3**

Prefinal Draft subject to Approval from EFRAG SRB [still subject to change]

4 dots to connect with examples

01

Pinpoint business activities, comprising those in the value chain.4

02

Identify IROs

03

Determine which IROs are material

04

Complete and organize your documentation

ESRS Annex II

Value chain: "the full range of activities, resources and relationships related to the undertaking's business model and the external environment in which it operates."

EFRAG publication IG 2: Value Chain Implementation Guidance

1st dot

01

Line up with the ESRS reporting level (subsidiary level or parent company level)

Collect your organization's information from your:

- ✓ Web site or other external materials
- ✓ Legal and regulatory environment
- ✓ Media reports & publications (also regarding your industry)
- ✓ Peer reports & sector-specific benchmarks
- ✓ Publications on sustainability trends & scientific findings

Useful tips:

1. Select upstream & downstream value chain activities
2. Check for related dependencies, resources, business relationships, geographical footprint & affected stakeholders
3. Create a register with all your activities to be comprised in the double materiality assessment

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02

Pinpoint IROs

Engage Stakeholders
Get feedback from internal & external stakeholders
Useful tips:
- ✓ Conduct proxy conversations, surveys, interviews
- ✓ Establish this as an ongoing due diligence process

Recognize Sustainability Matters
1. Make your list of sustainability matters according to ESRS 1, AR5 16
2. Consider and add your sector-specific & entity-specific matters
3. Include issues that are reported by:
   - Peers\ competitors
   - Financial analysts
   - Regulations or sector standards (SASB, GRI)

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02

Your organization's sustainability issues that are relevant:
(consider the following)

1. Is the issue regulated, or is disclosure of the issue required by a regulatory body?

2. Is disclosure of the issue required by relevant industry SASB standards or GRI sector standards?

3. Was the issue identified in a previous double materiality assessment?

4. Has the issue been identified in any research conducted (by ESG analysts, peers, etc.)?

5. Is the issue related to your organization's business activities or relationships or value chain dependencies or resources, or is it in the financial, regulatory, geopolitical, or regulatory environments in which you operate?

02

Impacts

"actual or potential, positive or negative impacts on people or the environment" (ESRS 1, Section 3.4)

Example:

If you identify "substances of concern" as a relevant subtopic *(see ESRS 1, AR 16)*, you should identify each individual substance of concern & get information about each instance (i.e., location, the related business activity, the quantity produced or procured, and the environmental impact)

Financial Risks and Opportunities

"sustainability matter is material from a financial perspective if it triggers or could reasonably be expected to trigger material financial effects on the undertaking" *(ESRS 1, paragraph 49)*

{a matter may be material from a financial perspective if it materially affects or is expected to materially affect an "undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital"}

2nd dot *(cont.)*

02

ESRS 1, paragraph 38: "impact materiality and financial materiality assessments are inter-related" and requires an entity to consider the "interdependencies between these two dimensions."
EFRAG's IG 1 paragraph 91: Materiality Assessment Implementation Guidance, "most impacts give rise to financial risks and opportunities."

Impacts That May Generate Financial Risks and Opportunities

Factors to be considered regarding IROs assessment for materiality:

1. Operational changes
2. Capacity to meet strategic goals
3. Capacity to follow to regulations
4. Reputational effects of its environmental or social impacts
5. Decreased operating expenses resulting from investments in energy-efficient technologies
6. Increased capital expenditures associated with facility upgrades or modifications
7. New access to capital with more favorable terms and lower interest rates
8. Modifications made to assets because of changing weather patterns such as increased flood risks
9. Accelerated decommissioning of assets because of commitments or loss of financial viability
10. Incurrence of costs associated with stranded assets and associated redundancies
11. Increased training costs to upskill workforce for new products or services
12. Revenue reduction linked to certain products or services
13. Increased insurance premiums or legal liabilities because of noncompliance with regulations, settlements, fines, or legal fees

3rd dot

03

- *"severity" of an IRO depends on its "scale," "scope," and "irremediable character" ESRS 1, AR 10*
- *"any of the three characteristics . . . can make a negative impact severe" ESRS 1, AR 11*

Material IROs:

The indicators and thresholds in a materiality assessment under ESRS 1 should consist of quantitative, qualitative information or both

When evaluate each IRO consider the following factors:

Scale (substantial, major, moderate, minimal)

How intense the negative or positive impacts are or potentially would be for people or the environment

Scope (high, moderate, low)

How extensive the negative or positive impacts are or potentially would be

Irremediable character (impossible, challenging, moderately difficult, easy)

How difficult it would be to remediate or reverse any actual damage

Likelihood (almost certain, likely, possible, unlikely)

How probable it is that the potential impact will occur or that the risk or opportunity will materialize

Magnitude (above or below the threshold)

How significant the financial effect would be if this risk or opportunity were to materialize

The scoring of each factor should be aggregated based on the approach and thresholds determined by your organization

3rd dot *(cont.)*

03

- Your organization should maintain documentation of management's decisions and outcomes for each IRO as part of your detailed documentation of the materiality assessment

- Your organization should describe how thresholds were determined and where management used judgment in applying the thresholds

4th dot

04

Complete and organize your documentation

To prepare your sustainability disclosures:

1. Map material IROs to related ESRS disclosure requirements & data points within the relevant topical standard to determine the information to be disclosed

2. If any industry and your organization’s specific IROs are material, specific disclosures must be provided to enable users to understand your IROs

ISSB Guidance

EFRAG and the International Sustainability Standards Board (ISSB) published interoperability guidance

The financial materiality assessment in ESRS 1 corresponds to the identification of information that is material for primary users of general-purpose financial reports in making decisions relating to providing resources to the entity (paragraph 48 of ESRS 1 & paragraph 18 of IFRS S1)

The definition of information that is considered material for users of general-purpose financial reports is aligned between the two sets of standards

Please note:

- **Double materiality approach under ESRS requires companies to disclose additional matters that may be material from an impact perspective**
- **ESRS require companies to evaluate sustainability matters that are incremental to those currently covered in IFRS S1 and S2**
- **Organizations should comply with all the requirements of both standards to claim they are reporting in accordance with either one**

Thank you for your attention!

Questions?

Contact

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