CSRD: Focusing on the financial

Design bridge and partners

16 October 2024

The clock is ticking for companies as the mandatory Corporate Sustainability Reporting Directive (CSRD) reporting deadline approaches for many.

While each organisation faces unique challenges in preparing, a common concern centres around financial materiality and its intersection with sustainability.

This article delves into the key pressure points causing anxiety for companies:

Data availability:
Meeting the stringent data requirements of the CSRD.

Subjectivity:
Navigating the complexities of subjective assessments and estimations within sustainability reporting.

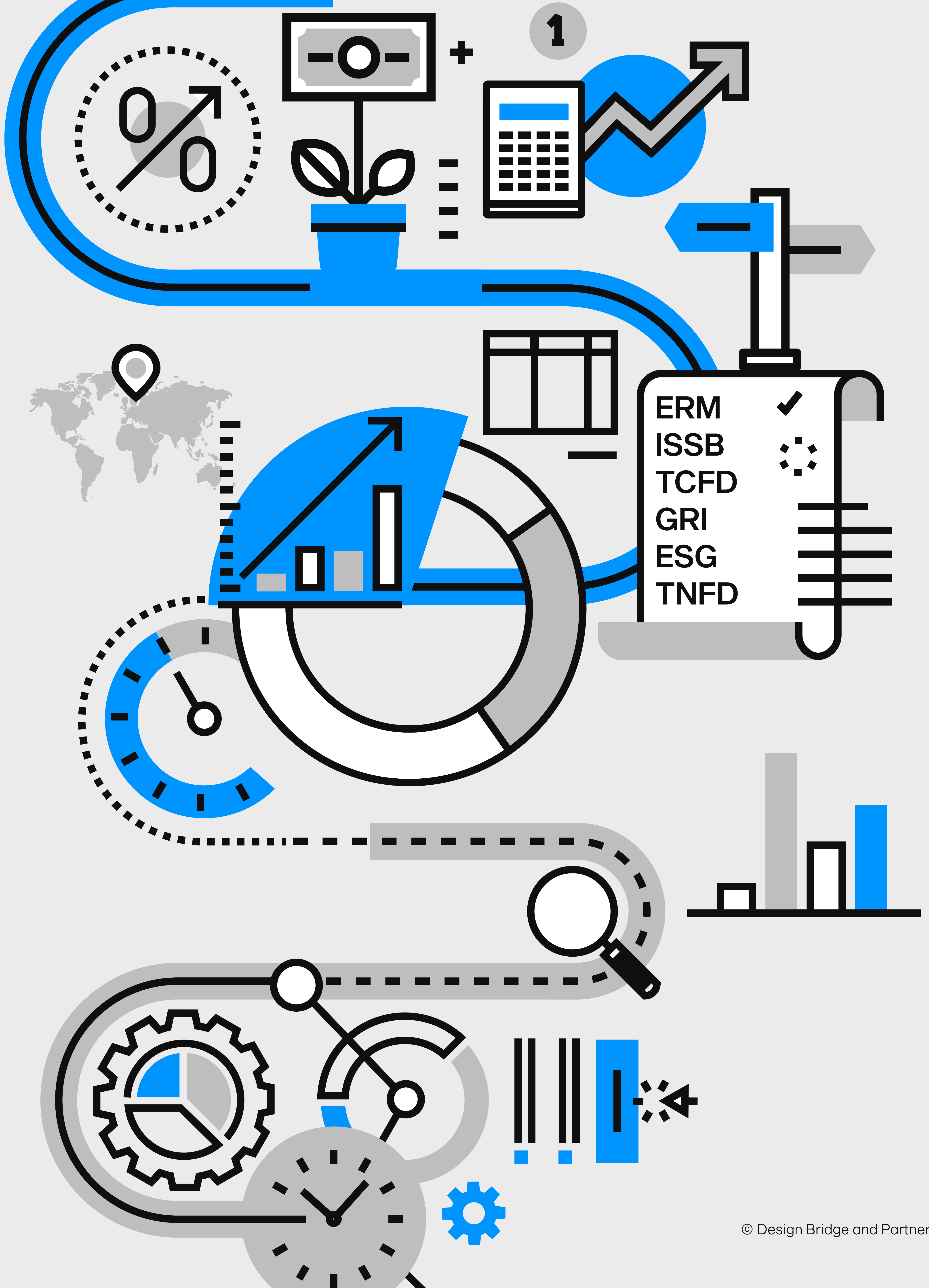
Value Chain Intricacies:
Addressing the challenges of gathering sustainability data across complex value chains.

We'll provide actionable, CSRD-aligned tips to help you overcome these hurdles and highlight best practices for reporting on financial materiality with clarity and confidence.

The context

The Corporate Sustainability Reporting Directive (CSRD) was created as a response to the growing investor need for sustainability related information from companies.

The CSRD aims to drive accountability and comparability across sustainability reporting, combatting the alphabet soup of sustainability frameworks and disclosures.



So, who does it impact?

Many companies will be required to report against CSRD as early as next year, with the deadline extending out to 2029 for non-EU companies with substantial activity in the EU.

50,000
European companies are anticipated to fall under the remit of CSRD

10,300
non-EU companies are expected to be subject to the CSRD

1,183
of those are within the UK

Source: LSEG

What's the temperature?

Whilst many companies are recognising the benefits...

84%

agree that integrated financial and ESG/ sustainability data enables better decision-making that can improve a company's financial performance.

Workiva
2024 ESG Practitioner Survey

81%

of companies not subject to the CSRD still intend to comply.

Workiva
2024 ESG Practitioner Survey

... they are also facing challenges along the way:

81%

of practitioners find collaborating across departments involved in sustainability reporting challenging with 25% finding it very challenging.

Workiva
2024 ESG Practitioner Survey

59%

of survey respondents cited data availability and quality as the toughest challenge for CSRD reporting.

pwc
2024 Global CSRD survey

Only 20%

of the companies required to report in 2025 have validated the availability and completeness of data for their disclosures.

pwc
2024 Global CSRD survey

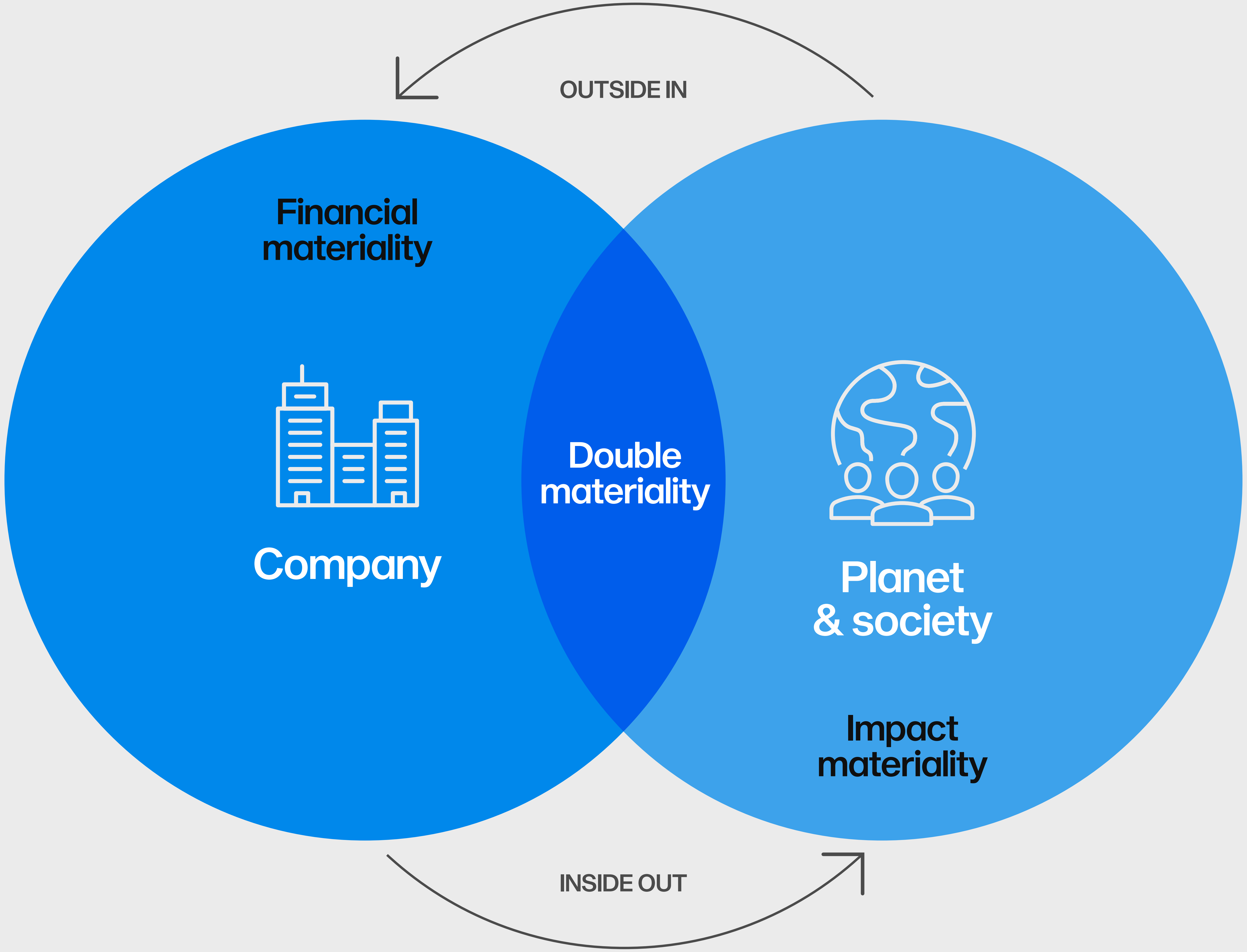
Double materiality

What is it?

A core component of CSRD is the concept of double materiality.

This requires companies to identify the sustainability issues that are financially and/or impact material to their business.

This is presenting fresh challenges for companies, particularly when it comes to financial materiality.



What is it?

Financial materiality

A sustainability matter is financially material if it triggers or could reasonably be expected to trigger material financial effects on a company.

Financial effects could cover a company’s development, financial position, financial performance, cash flows, access to finance or cost of capital over the short, medium or long-term.

Impact materiality

A sustainability matter is material from an impact perspective when it relates to a company’s material impacts on people or the environment.

These can be actual or potential, positive or negative impacts, and should be considered over the short, medium and long-term.

Financial materiality
The concerns

The context

While finance teams possess deep expertise in financial materiality for traditional reporting, applying this lens to sustainability has proven challenging.

This difficulty is often compounded by siloed organisational structures, where knowledge gaps in sustainability and ESG principles are prevalent.

As companies strive to bridge the gap between sustainability and finance, several common roadblocks are emerging.

71%

of survey respondents in 2023 said three or more internal teams were involved in their company's ESG reporting processes, this year that increased to 78%.

Workiva
2024 ESG Practitioner Survey

Key pinch points

Data availability

Companies don't have the data available to report against all CSRD's stringent metrics.

Subjectivity

The high degree of estimation uncertainty involved in financial materiality raises concerns that results won't stand up to assurance scrutiny.

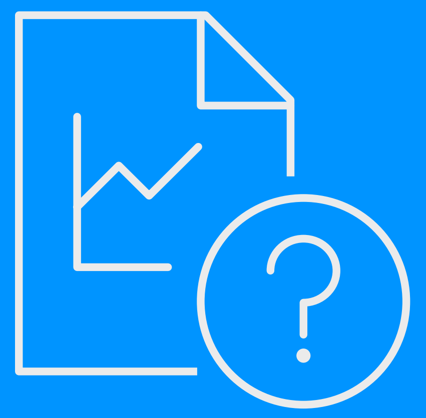
Value chain

Companies with complex supply chains may have little oversight over their entire chain, making it difficult to understand how material topics impact different aspects of their operations.

The pinch points

Data availability

CSRD data requirements can be burdensome, with many companies lacking sufficient data to be able to report under the multitude of metrics and targets associated with each material topic. The CSRD recognises the need for flexibility, allowing companies to use estimates where necessary and communicate any limitations in their data collection process.



The CSRD guidance outlines that: "If the undertaking cannot disclose the information prescribed ... because it has not adopted the respective policies, implemented the respective actions or set the respective targets, it shall disclose this to be the case and it may report a time frame in which it aims to have these in place."

DBP guidance:

Break down silos by encouraging knowledge sharing between sustainability, finance, and wider teams. This integrated approach will strengthen data collection processes and ensure a unified understanding of materiality.

Focus on reporting metrics where data is readily available and be upfront about any limitations or data gaps. Transparency builds trust with stakeholders and demonstrates a commitment to continuous improvement.

The pinch points

Subjectivity

Due to the limited data availability and evolving methodologies, quantitative metrics may be difficult to measure directly. Subjectivity is likely to feature heavily as estimation uncertainty arises.

The CSRD guidance outlines that: "The use of reasonable assumptions and estimates is an essential part of preparing sustainability-related information and does not undermine the usefulness of that information, provided that the assumptions and estimates are accurately described and explained."

DBP guidance:

Maintain meticulous documentation of all assumptions, estimates and methodologies employed throughout the materiality assessment. Clearly articulate these within your reporting, emphasising transparency where subjective judgment was necessary.

While the CSRD allows for estimates, these must be well-founded and defensible. Engage SMEs to ensure the accuracy and credibility of your estimates, strengthening your reporting's resilience to scrutiny.

The pinch points

Value chain

Navigating complex value chains can pose a significant challenge when reporting against ESRS requirements. The CSRD recognises this complexity and offers flexibility. Companies can use estimates where necessary and communicate any limitations in their data collection or reporting processes.

The CSRD guidance outlines that: "Where the undertaking cannot collect the information about its upstream and downstream value chain after making reasonable efforts to do so, the undertaking shall estimate the information to be reported about its upstream and downstream value chain, by using all reasonable and supportable information, such as sector-average data and other proxies.

DBP guidance:

Given the greater leniency applied by CSRD in the first 3 years of reporting, companies should use this as an information gathering opportunity to establish a more interconnected network along the value chain.

Identify why certain information isn't available and how you plan to obtain this information in the future.

Financial materiality
Best practice

Best practice reporting

We have reviewed over 20 different European companies to identify where there are areas for improvement in reporting on financial materiality and also see who is showing signs of best practice in this area.

Prominent reporting gaps

Ambiguous timelines:

Many companies are providing undefined timelines without articulating the specific timeframes these represent, hindering stakeholders' ability to assess short-, medium- and long-term implications.

Vague materiality thresholds:

Financial materiality assessments frequently rely on imprecise terminology (e.g., low, medium, high) without clear definitions or quantitative thresholds. This makes it hard for the reader to understand what the cut-off is for materiality.

Opaque processes:

Reporting often lacks transparency regarding the methodologies used to determine financial materiality. Companies should clearly articulate the processes employed, including the specific financial accounts considered and reason for their selection.

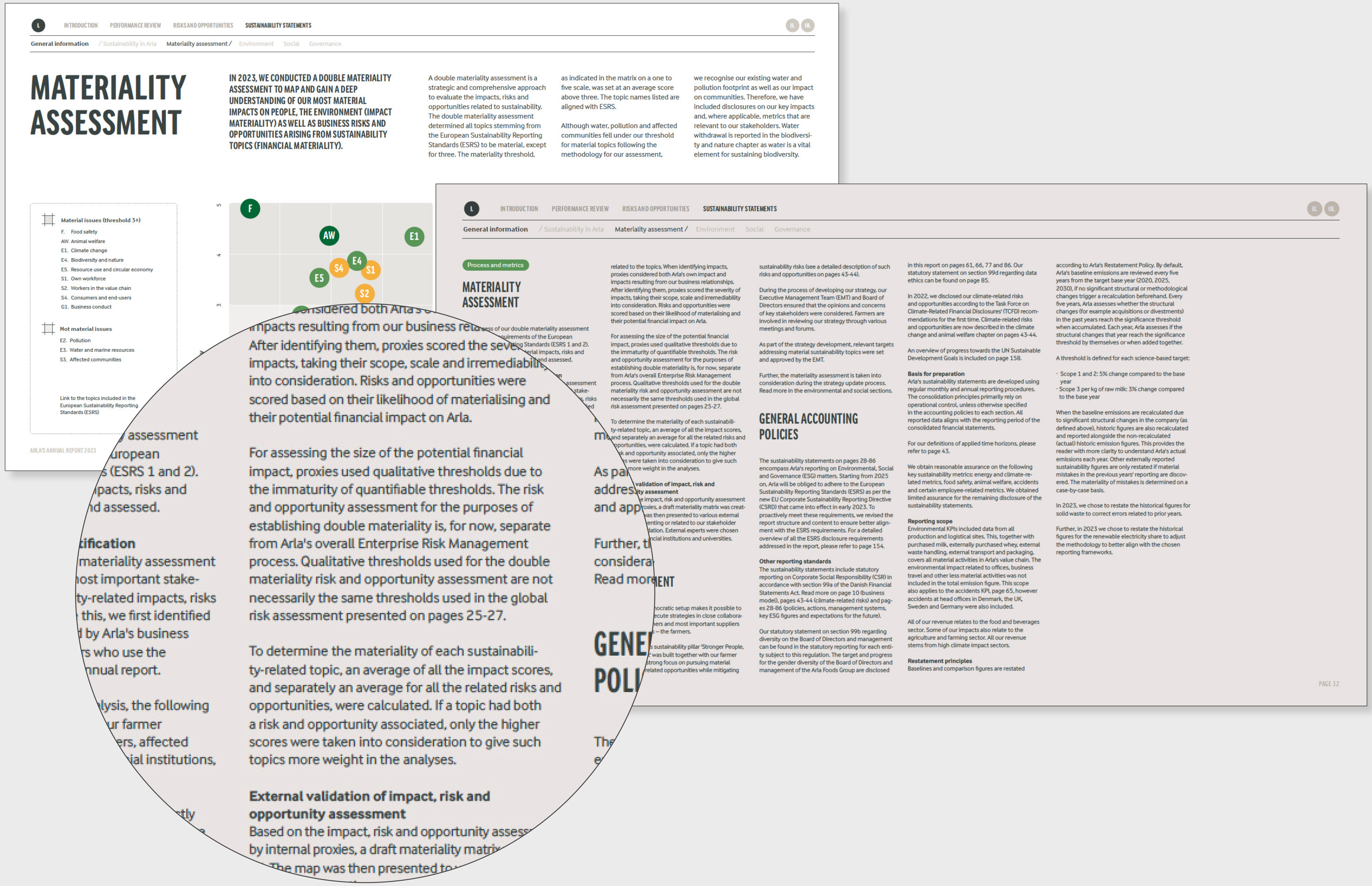
Opportunity vs risk:

Many companies fail to differentiate between financial risks and opportunities associated with sustainability issues. This distinction is crucial for stakeholders to understand the full spectrum of potential financial ramifications.

Best practice examples

Arla identifies up front the limitations of its financial materiality assessment, acknowledging its use of qualitative rather than quantitative thresholds for assessing financial impact.

> "For assessing the size of the potential financial impact, proxies used qualitative thresholds due to the immaturity of quantifiable thresholds...
>
> ...Qualitative thresholds used for the double materiality risk and opportunity assessment are not necessarily the same thresholds used in the global risk assessment."
>
> Arla Annual Report 2023, page 32



[Full report see here]

Best practice examples

Ørsted

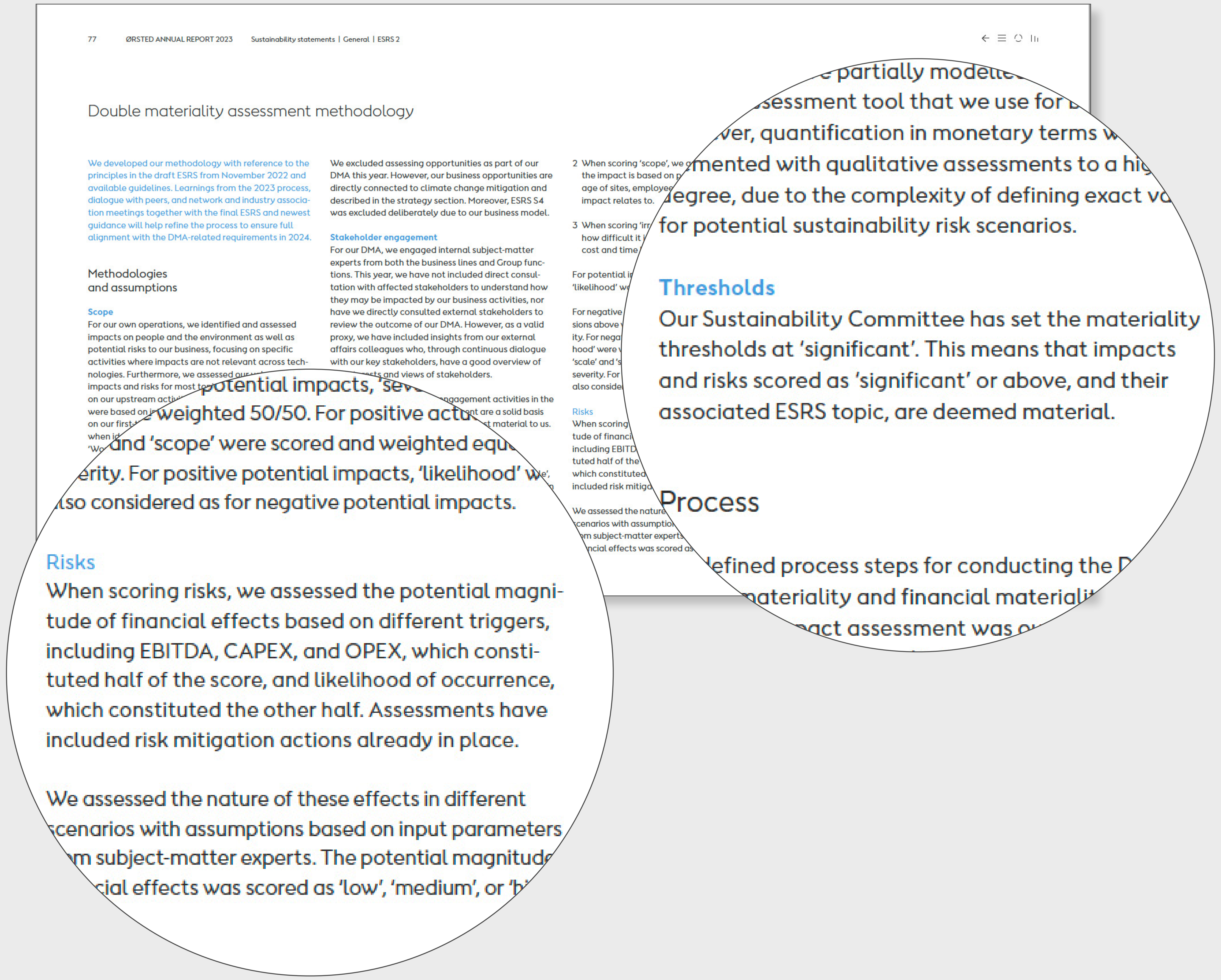
Orsted demonstrates a high degree of transparency in its reporting, identifying the financial accounts involved in determining financial materiality.

It acknowledges the limitations of its quantitative analysis, highlighting the complexity involved in determining exact financial impacts.

"When scoring risks, we assessed the potential magnitude of financial effects based on different triggers, including EBITDA, CAPEX, and OPEX, which constituted half of the score, and likelihood of occurrence, which constituted the other half. Assessments have included risk mitigation actions already in place."

"Quantification in monetary terms was supplemented with qualitative assessments to a high degree, due to the complexity of defining exact values for potential sustainability risk scenarios."

Orsted Annual Report 2023, page 77



Orsted clearly labels its threshold for materiality as "significant", with anything below this not being material. This combats the lack of clarity that can arise when non-CSRD terms are used in place of "material".

"Our Sustainability Committee has set the materiality thresholds at 'significant'. This means that impacts and risks scored as 'significant' or above, and their associated ESRS topic, are deemed material."

Orsted Annual Report 2023, page 77

[Full report see here]

Best practice examples

BAT clearly identifies its financial materiality numerical thresholds and helpfully articulates the specific years associated with each of its time frames.

> “The following financial magnitude criteria were used to guide stakeholder scores: High Impact (in excess of £250 million); Medium Impact (£120-250 million); Low Impact (up to £120 million); None (£0), each on an annual basis. Each of these three impact dimensions were assessed across two time horizons: – Short- and medium-term: from 0 to 5 years; and – Long-term: more than 5 years.”
>
> BAT Annual Report and Form 20-F 2023, page 74

[Full report see here]

Best practice examples

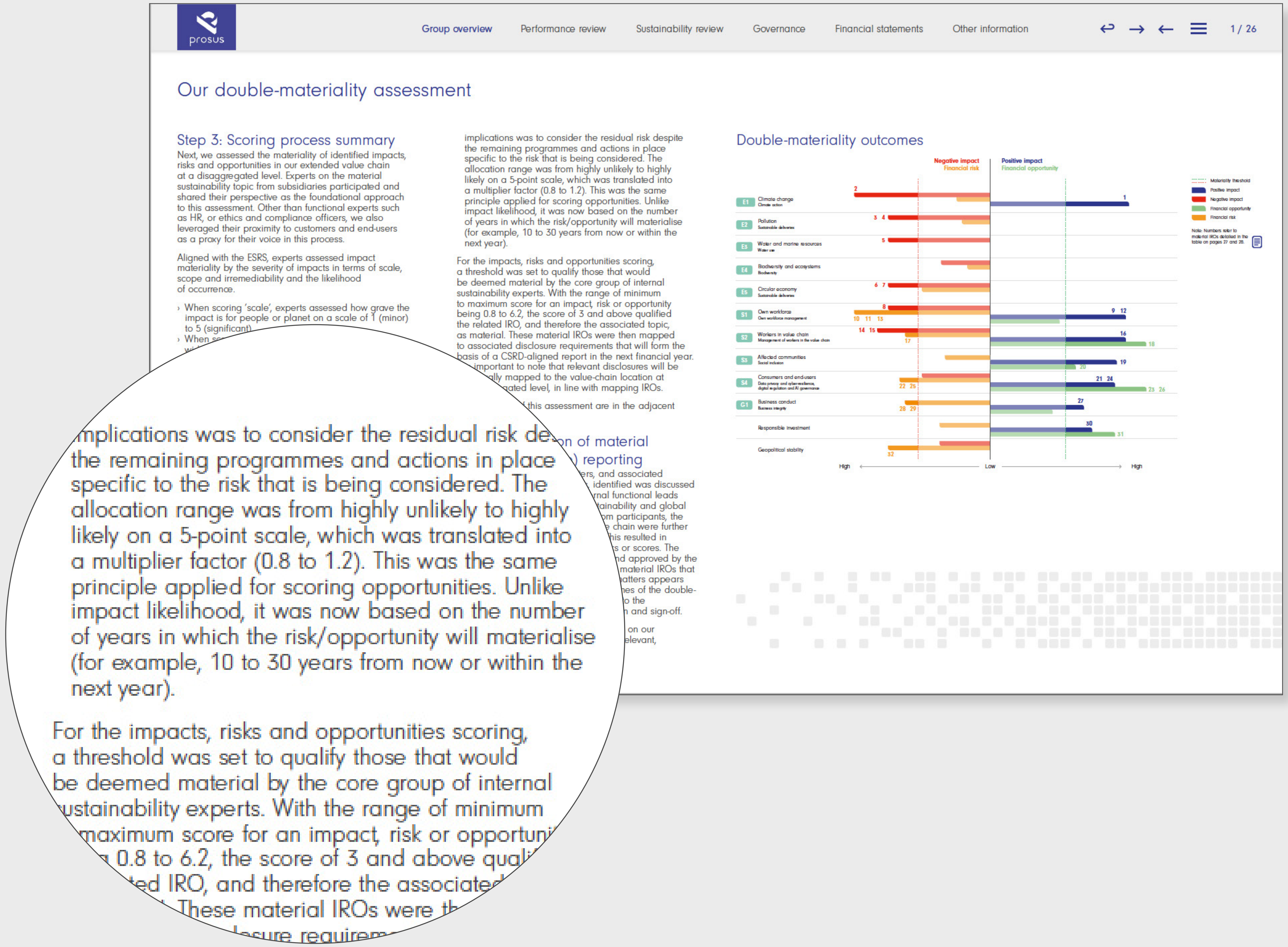
In describing its financial materiality methodology, Prosus stands out for providing transparency around the calculations used in its analysis, identifying the multiplier factors linked to its scoring system of 1-5.

Furthermore, Prosus identifies the specific score over which a topic is considered material rather than using abstract terms such as low, medium and high.

"The allocation range [for likelihood] was from highly unlikely to highly likely on a 5-point scale, which was translated into a multiplier factor (0.8 to 1.2). This was the same principle applied for scoring opportunities."

"With the range of minimum to maximum score for an impact, risk or opportunity being 0.8 to 6.2, the score of 3 and above qualified the related IRO, and therefore the associated topic, as material."

Prosus Annual Report 2024, page 26



Full report see here

Best practice examples

Carlsberg uses a simple yet effective table to identify its time horizons, covering short, medium and long-term. Furthermore, for each of its material topics it clearly distinguishes whether they are impact or financially material, and whether they are a positive vs negative impact or a risk vs opportunity.

Carlsberg Group ESG Report 2023, page 93

CARLSBERG GROUP ESG REPORT 2023 **GOVERNANCE AND TRANSPARENCY** 93

IDENTIFYING OUR PRIORITIES

We aim to ensure that our work remains focused on the ESG topics that are most significant to our business and our stakeholders – our most material topics.

FOCUSING ON OUR MOST MATERIAL TOPICS
Our TTZAB programme was informed by our 2020 materiality assessment, which identified where we can have the most positive economic, environmental and social impact.

In 2023, we conducted a preliminary double materiality assessment in line with the CSRD requirements and the ESRS framework as part of our preparations towards CSRD-aligned reporting (see page 92). We are voluntarily disclosing a summary of the preliminary results this year (see below), and plan to disclose the results of our next assessment, to be conducted in 2024 (the first year in which we must comply with the CSRD), in more detail.

The preliminary assessment this year confirmed that our TTZAB programme focuses our actions and commitments in the areas that are most material for our business and our stakeholders. A simplified mapping of ESG topics – as defined by the ESRS framework – against our TTZAB focus areas illustrates how our programme helps us to address material impacts, mitigate material risks and capture material opportunities (see page 94).

ASSESSING DOUBLE MATERIALITY
A double materiality assessment considers the materiality of each ESRS topic, sub-topic and sub-sub-topic based on the impact our business can have on people and the environment, and on the financial risks and opportunities to our business stemming from these same topics.

Our preliminary double materiality assessment identified material impacts within all ten ESRS topics, and financially material medium- and long-term risks and opportunities within three of them. Using this as a starting point, we will conduct deep-dive analyses into these material impacts, risks and opportunities to enhance inputs to our 2024 assessment.

The table below summarises the materiality of each of the ten ESRS topics. We will disclose further detail on sub-topics and datapoints, structured according to the ESRS framework, in our reporting for 2024 based on our next materiality assessment with enhanced inputs.

OUR ASSESSMENT PROCESS
We set up a steering committee that included senior leaders from our Group Finance, Risk Management and ESG functions to oversee our materiality process. We also engaged an external consultancy to support us in ensuring our methodology aligns with the CSRD requirements and to conduct the assessment as an objective third party, in line with the agreed methodology and based on the various inputs gathered.

We ran a series of workshops to gather input from more than 40 relevant experts and senior leaders in the business, conducted together with external subject matter experts. We also conducted 12 interviews with external stakeholders representing our value chain (such as suppliers and customers), investors and civil society. In addition to the inputs gathered from internal and external stakeholders, we took into account a wide range of internal and external inputs, including relevant publications by expert institutions

PRELIMINARY DOUBLE MATERIALITY ASSESSMENT 2023: SUMMARY OF RESULTS

	IMPACT MATERIALTY			FINANCIAL MATERIALITY		
EUROPEAN SUSTAINABILITY REPORTING STANDARDS	**Material impact(s) affecting people and the environment** [Yes/no]	**If yes, type of material impact(s) identified** [Positive and/or negative]	**If yes, impact time horizon(s)** [Short-term: 12-18 mos; medium-term: 18 mos – 7 yrs; long-term: 7+ yrs]	**Material financial effects(s) affecting Carlsberg's ability to create value** [Yes/no]	**If yes, type of material financial effect(s) identified** [Risk and/or opportunity]	**If yes, effect time horizon(s)** [Short-term: 12-18 mos; medium-term: 18 mos – 7 yrs; long-term: 7+ yrs]
E1: Climate change	Yes	Positive & negative	Short-, medium- & long-term	Yes	Risk	Long-term
E2: Pollution	Yes	Negative	Short-, medium- & long-term	No	-	-
E3: Water & marine resources	Yes	Positive & negative	Short-term	No	-	-
E4: Biodiversity & ecosystems	Yes	Positive & negative	Short-, medium- & long-term	No	-	-
E5: Resource use & circular economy	Yes	Positive & negative	Short-, medium- & long-term	Yes	Opportunity	Long-term
S1: Own workforce	Yes	Positive & negative	Short-, medium- & long-term	No	-	-
S2: Workers in the value chain	Yes	Positive & negative	Short- & medium-term	No	-	-
S3: Affected communities	Yes	Positive & negative	Short-, medium- & long-term	No	-	-
S4: Consumers & end-users	Yes	Positive & negative	Short-, medium- & long-term	Yes	Risk & opportunity	Medium- & long-term
G1: Business conduct	Yes	Positive & negative	Short-term	No	-	-

Full report see here

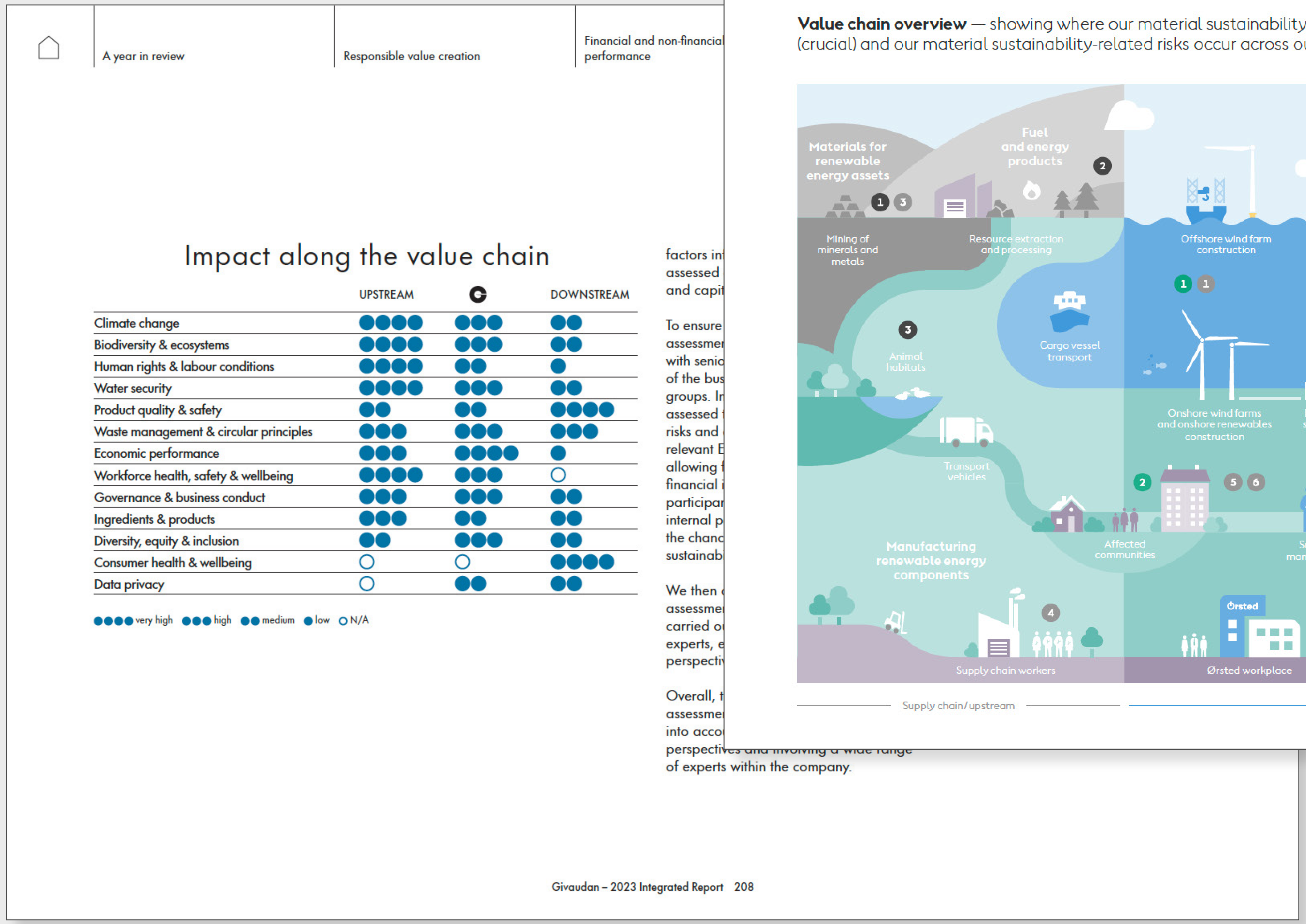
Best practice examples

Givaudan

Ørsted

Companies like Givaudin and Orsted take their disclosures a step further and use tables and infographics to identify where each of the material issues has an impact along the value chain.

Givaudin Integrated Report 2023, page 208



A year in review | Responsible value creation | Financial and non-financial performance

Impact along the value chain

	UPSTREAM	Givaudan	DOWNSTREAM
Climate change	●●●●	●●●	●●
Biodiversity & ecosystems	●●●●	●●●	●●
Human rights & labour conditions	●●●●	●●	●
Water security	●●●●	●●●	●●
Product quality & safety	●●	●●	●●●●
Waste management & circular principles	●●●	●●●	●●●
Economic performance	●●●	●●●●	●
Workforce health, safety & wellbeing	●●●●	●●●	○
Governance & business conduct	●●●	●●●	●●
Ingredients & products	●●●	●●	●●
Diversity, equity & inclusion	●●	●●●	●●
Consumer health & wellbeing	○	○	●●●●
Data privacy	○	●●	●●

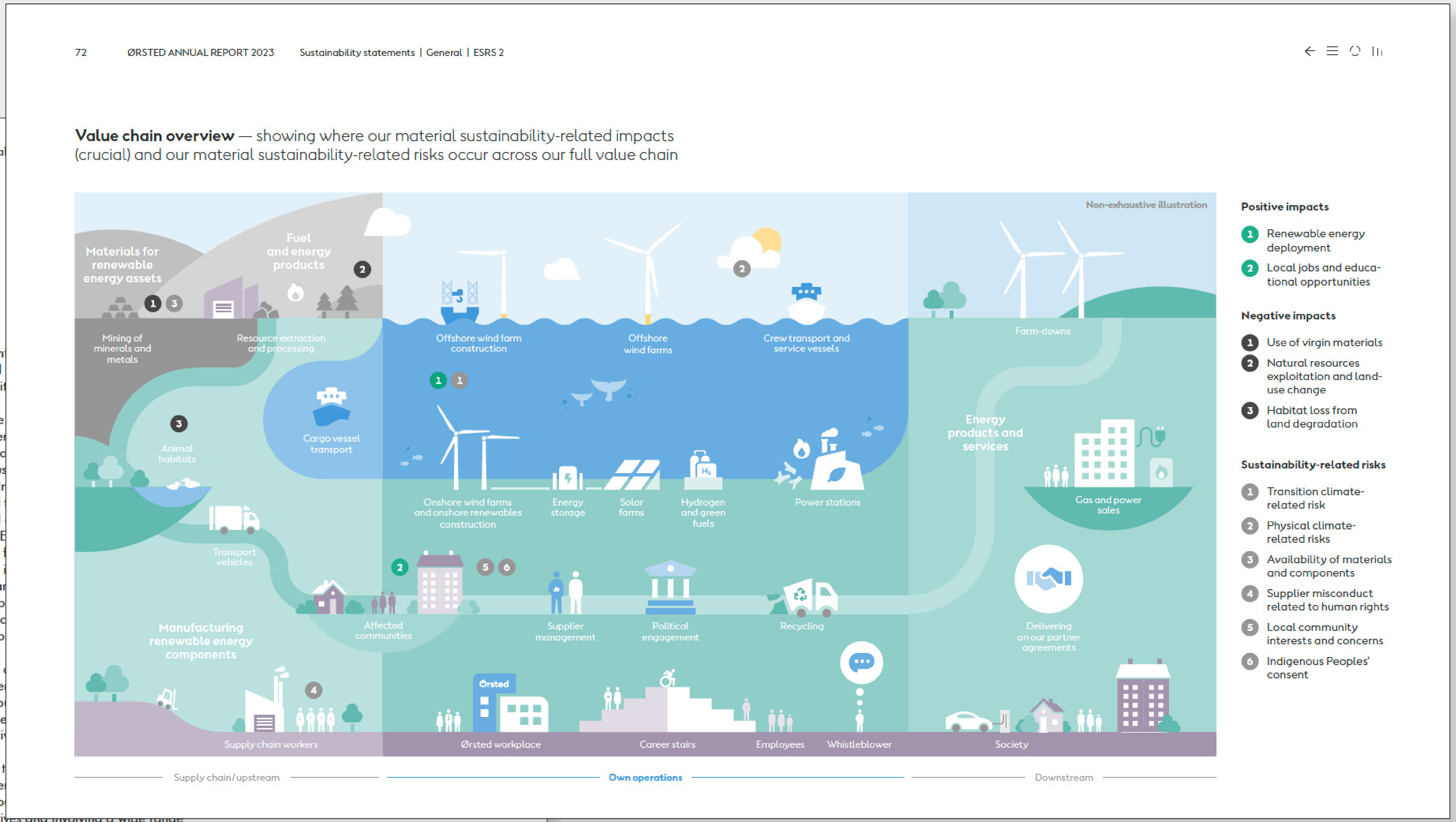
●●●● very high ●●● high ●● medium ● low ○ N/A

of experts within the company.

Givaudan – 2023 Integrated Report 208

Full report see here

Orsted Annual report Report 2023, page 72



Full report see here

Key takeaways

Our key recommendations

1
Embrace transparency:

Openly acknowledge any areas where subjective judgments or estimates were necessary. Articulate the rationale behind these decisions and outline your roadmap for enhancing objectivity and data accuracy over time.

2
Detail the methodology:

Offer readers a detailed walkthrough of your financial materiality assessment methodology, specifying the financial accounts considered and the quantitative thresholds employed to determine materiality. Document the expertise and perspectives involved in the decision-making process, including the involvement of subject matter experts.

3
Foster cross-functional collaboration:

Break down silos and foster a culture of collaboration between sustainability, finance, and other relevant teams. Leverage this opportunity to upskill teams on ESG principles and financial reporting best practices. Enhanced information sharing and data accessibility will streamline the materiality assessment process and improve data quality.

How our team can help you...

Annual Reporting

We provide expert guidance on crafting annual reports that align with listing requirements, regulations, and investor expectations.

We help you articulate your value proposition and effectively communicate your financial and operational performance.

Sustainability Reporting

We offer tailored advice to align your sustainability reporting with the shifting regulatory context and stakeholder expectations.

We help you articulate your commitment to environmental, social, and governance (ESG) factors and demonstrate your progress towards a sustainable future.

Double Materiality

Aligning with the Corporate Sustainability Reporting Directive (CSRD) is crucial.

We help you understand your most salient sustainability impacts, risks, and opportunities, enabling you to develop a robust and transparent reporting framework.

Strategic Consultancy

We offer a comprehensive basket of consultancy services to support your sustainability journey, including:

- UNGC COP Alignment
- Impact Reporting Advice
- SASB and GRI Alignment
- Branding

We are a centre of excellence

We are an award-winning group of sustainability experts, chartered accountants, project managers and creatives within the Design Bridge and Partners global network.

We've been helping clients deliver great reports for over 40 years – first as Addison Group, recently as Superunion, and now as Design Bridge and Partners – a new global design-led company with increased capabilities, expertise, skill sets, geographic locations and reach.

Thank you

If you would like to find out more about how we can help you to fulfil your CSRD reporting requirements, please contact Selabe Kute in our Sustainability and Corporate Reporting team using the email address below.

selabe.kute@designbridge.com