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MATERIALITY CONCEPT(S) IN THE EU SUSTAINABILITY (NON-FINANCIAL) REPORTING: THE CHALLENGE OF EQUIVALENCE

Summary

This paper presents different materiality concepts in sustainability reporting. At present, two main streams of materiality concepts in sustainability reporting are single and double materiality. While single materiality primarily deals with the financial impact of sustainability issues on enterprise value (outside-in perspective), double materiality is more far-reaching and deals with both the financial impact and the social impact of companies' operations, i.e. how companies' operations affect society and the environment (inside-out perspective). Both concepts are present in leading sustainability reporting standards. The EU has opted to develop its own set of standards and is, in addition to the GRI, the main representative of double materiality as the European Sustainability Reporting Standards (ESRS) place this concept in the spotlight. The IFRS Foundation is the main representative of single materiality.

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This section will present the main characteristics of both concepts. It will then present the path to standardising reporting standards in the EU. Finally, implications of the different benchmarks employed in standards to define materiality will be explored.

Key words: *Single Materiality. – Double Materiality. – ESRS. – IFRS. – Sustainability Reporting.*

I Introduction

Transition to a more sustainable and inclusive economy remains high on the agenda of the EU, and sustainability reporting is one of the backbones in achieving this goal. In 2014, the EU introduced mandatory non-financial reporting with the Non-financial Reporting Directive (NFRD).[1] The Directive introduced a duty for large undertakings, which are public interest entities and have an average number of 500 employees, to report on certain issues. These undertakings were required, unless exempted from this duty under certain conditions, to report on issues relating to environmental, social, and employee matters, human rights, anti-corruption, and bribery. The information required included disclosure of the business model; policies pursued in relation to the above-mentioned matter, including due diligence procedures; results, risks and risk management, and key performance indicators relevant to the business.[2] With the exception of a few countries within the EU, such as Denmark, few countries had a regime of this type of disclosure in place, which meant that this Directive represented a novel approach for many.[3]

The EU started with a light, not too-intrusive approach, meaning that both the material and personal scope of the adopted Directive on non-financial reporting were quite limited. This was done intentionally. Namely, the NFRD was supposed to introduce minimum requirements but also to remain flexible enough in order to allow companies to determine which

1 In this paper we will use the terms 'non-financial' and 'sustainability' information interchangeably, unless expressly stated otherwise.

2 *Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance*, *OJ* L 330, 15. 11. 2014; further referred to as NFRD, Art. 19a. *See* Dániel Gergely Szabó, Karsten Engsig Sørensen, „New EU Directive on the Disclosure of Non-financial Information (CSR)", *ECFR*, Vol. 12, Nr. 3/2015.

3 *See Ibid*., 309.

issues are most relevant to them.[4] Of course, the question of cost-benefit balance was also important. The level of flexibility was pretty high: several exemptions from the duty to disclose certain information were envisaged, and the principle of 'comply or explain' was embedded in this directive. In addition to that, companies were not required to use certain reporting frameworks (standard). Instead, they had the option of employing either a national or an international framework. Finally, no mandatory audit of information was envisaged. Auditors were only required to ascertain whether a non-financial statement was provided. The decision as to whether to request an audit of the content of the non-financial report was left to the discretion of the Member States.

While the introduction of mandatory sustainability reporting was certainly a major step forward in achieving a more sustainable and resilient economy, significant shortcomings were identified. Due to these flaws, but also the ambition to achieve equivalence of financial and sustainability reporting and strengthen reporting requirements, amendments followed in 2022.[5] Although the core of the NFRD was preserved, significant novelties were introduced by the CSRD.

Firstly, the personal scope of the application was extended to include not only large companies but also small and medium-sized enterprises that are public interest entities.[6] Secondly, the CSRD employs a more detailed approach to reporting requirements, specifying in greater detail what should be included in a sustainability report.[7] Furthermore, compared to the NFRD, which did not require a mandatory audit of information, the CSRD demands limited assurance.[8] Reasonable assurance would significantly contribute to the

4 Daniel Gergely Szabo, *Mandatory Corporate Social Responsibility in the EU*, Eleven Publishing, The Hague, 2016, 138.

5 Deirdre Ahern, The Sustainability Reporting Ripple: Direct and Indirect Implications of the EU Corporate Sustainability Reporting Directive for SME Actors, available at: *https://ssrn.com/abstract=4517356*, 20. 5. 2024, 1–2.

6 *Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (Text with EEA relevance)*, *OJ* L 322, 16. 12. 2022; further referred to as CSRD; *Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance*, *OJ* L 182, 29. 6. 2013; further referred to as Accounting Directive. CSRD modifying art. 40(a) Accounting Directive.

7 Compare NFRD art. 1 inserting art. 19a in Accounting Directive and Article 19a as amended by CSRD.

8 *Commission staff working document impact assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council amending*

reliability of the information. However, due to the fact that reporting practices are still not well developed in most companies, the relative immaturity of the assurance market for nonfinancial information, as well as the absence of assurance standards for non-financial information, the EU Commission opted for limited assurance. Despite the fact that limited assurance would not contribute to the same extent to the reliability and comparability of information, it still improves the framework in these terms and is less financially burdensome for companies subject to reporting. In conclusion, the objective of the CSRD is to address concerns regarding the comparability and reliability of the information. In alignment with this objective, the EU has taken the initiative to develop its own set of standards. This task has been assigned to the European Financial Reporting Advisory Group (EFRAG), which has developed the first set of standards – the European Sustainability Reporting Standards (ESRS), formally adopted in 2023.

One of the main features of the ESRS is *double materiality*. The double materiality principle implies that companies must go beyond providing information on how sustainability matters affect companies (*outside-in* perspective) and also have to report on how companies' activities affect society and the environment (*inside-out* perspective). The principle of double materiality, however, is not new. Namely, the NFRD required undertakings to disclose 'information to the extent necessary for an understanding of the undertaking's development, performance *and* impact of its activity...'[9] Reference to the company's position pertains to the financial impact, while its impact on society in wider sense pertains to environmental and social impact, as was later explained in Commission's 2019 Guidelines on non-financial reporting.[10] Confusion was most probably caused by the fact that the term 'impact' was not clear, i.e., the word 'materiality' was not used in the NFRD.[11] Through the ESRS, the CSRD sets the stage for a more standardised and harmonised approach to sustainability reporting in the Member States. This is certainly one of the most important novelties introduced with amendments to the CSRD, as one of the priorities was to introduce a single, mandatory standard at the EU level.

Contrary to double materiality, *single materiality* is limited to an assessment of financial impact, i.e. how ESG matters affect companies' value. At the moment, generally speaking, the sustainability reporting framework is

Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting {COM(2021) 189 final} – {SEC(2021) 164 final} – {SWD(2021) 151 final}, 37.

9 NFRD, Art. 1 inserting Art 19a in Directive 2013/34/EU.

10 European Commission, *Study on the Non-Financial Reporting Directive: Final Report* (further referred to as: NFRD Study), 101–102.

11 *Ibid*.

largely polarised between single and double materiality concepts. Therefore, we aim to provide an overview of the main characteristics of materiality and the main differences between the concepts of single and double materiality. This paper is organised as follows. *Chapter II* deals with the notion and historical roots of the principle of materiality, with the aim of providing an overview and function of materiality in financial and sustainability reporting. This is followed by *Chapter III*, which deals with standardisation in the EU and the development of the ESRS standards (*Section 1*). The next section (*Section 2*) considers definitions and main features of single and double materiality. The paper will further delve into the question of benchmarks used for materiality, i.e. whether investor or shareholder lenses are used to determine the materiality of information and the main implications of those approaches (*section 3*). We conclude by summarising the main findings in *Chapter IV*.

II The Notion and Historical Root of Materiality

The issue of identifying relevant (material) information is arguably as old as it is corporate disclosure itself. The determination of which information is material, as well as the quantity of information which is material, depends significantly on the context in which companies operate. It is also essential to whom information is provided. Furthermore, the materiality of information is time-sensitive: what is material in one moment may become immaterial at a later stage, and *vice versa*. In the past few years, especially with constant pressure to incorporate CSR and to disclose non-financial/sustainability information, the amount of information to be disclosed by companies has increased significantly. It is evident that not all available information can be relevant. This is especially challenging for large companies, which often deal with a large amount of information, and it would neither be possible nor desirable to disclose all available information to market participants.[12]

The concept of materiality evolved precisely in response to the need to identify relevant information in order to avoid omission, but also information overload as users are not able to process all information. Materiality, therefore, serves several functions. First, regulators use the principle of materiality to define legal obligations, i.e. what needs to be disclosed.[13] For reporting

12 Chiara Mosca, Chiara Picciau, „Making Non-Financial Information Count: Accountability and Materiality in Sustainability Reporting", *Finance durable et droit: perspectives comparées* (eds. Hugues Bouthinon-Dumas, Bénédicte François, Anne-Catherine Muller), Paris, 2020, 182.

13 Ruth Jebe, „The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream", *American Business Law Journal*, Vol. 56, Nr. 3/2019, 649.

entities, this principle guides them to identify relevant information. Investors and other users use this principle to clearly identify the information necessary to make informed (investment) decisions.[14] In a nutshell, materiality serves to separate what *should* be from what *could* be disclosed.[15] Considering the amount of data and different contexts companies operate in, it is also necessary to have some flexibility in this regard. This is the primary rationale behind the *de facto* autonomy that companies enjoy in determining materiality.[16] It is also important to recognise that materiality itself is not a static concept.[17] As we have previously discussed, materiality is significantly influenced by context, timing, and audience, among other factors.

The principle of materiality is very well known and originates from accounting law. Definitions of materiality from accounting law influenced in general financial markets regulation, thus, there is a significant overlap of definitions.[18] Despite the fact that the concept of materiality has been known for a long time, it was not always very clear, even in accounting law practice, due to the fact that international organisations usually provide fairly general and principle-based guidance on determining whether information is material.[19]

Materiality is similarly defined by two dominant actors in financial reporting standard setting – the International Accounting Standards Board (IASB), well known for internationally used International Financial Reporting Standards (IFRS), and the Financial Accounting Standards Board (FASB), which produced Generally Accepted Accounting Principles (GAAP), which are used primarily in the USA.

IFRS (IASB) defines material information as follows:[20]

14 *Ibid.*

15 *Ibid.*, 650.

16 Lars Moratis, Luc van Liedekerke, „Materiality in sustainability reporting according to the European Sustainability Reporting Standards: (What) does it matter?", available at: *https://ssrn.com/abstract=4702851*, 10. 5. 2024, 2.

17 Namely, World Economic Forum mentions 'dynamic' materiality. According to this concept, what is *financially* immaterial now can become material in future. More on this concept: World Economic Forum, Embracing the New Age of Materiality: Harnessing the Pace of Change in ESG, March 2020, available at: *https://www.weforum.org/publications/embracing-the-new-age-of-materiality-harnessing-the-pace-of-change-in-esg/*, 10. 5. 2024.

18 C. Mosca, C. Picciau, 23.

19 Robert G. Eccles, Michael P. Krzus, Jean Rogers, George Serafeim, „The Need for Sector-Specific Materiality and Sustainability Reporting Standards", *Journal of Applied Corporate Finance*, Vol. 24, Nr. 2/2012, 65.

20 IFRS IAS 1, Presentation of Financial statements, available at: *https://www.ifrs.org/issued-standards/list-of-standards/ias-1-presentation-of-financial-statements/*, 20. 5. 2024.

> 'Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.'
>
> GAAP (FASB):
>
> 'the omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.'

Since non-financial/sustainability reporting is within the scope of the Accounting directive as the CSRD requires sustainability reports to be published within the management report,[21] which is part of the annual financial statement, it seems pertinent to take a brief look at how materiality is defined in the Accounting Directive:[22]

> 'material means the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking. The materiality of individual items shall be assessed in the context of other similar items'

Although we cannot reduce the analysis to terminological differences, as this issue is very complex and the use of different reporting frameworks can lead to different outcomes, we can observe that the terminology used in the IFRS and the GAAP is slightly different. Some authors highlight, for instance, the fact that the GAAP definition relies on probability in affecting users' decisions, whereas the IFRS uses the term 'could'.[23] The IFRS and the GAAP standards also use, to some extent, different benchmarks. For example, the IFRS mentions '*primary users of general-purpose financial statements*', the GAAP mentions '*reasonable person*', while the Accounting directive refers to '*user*'. Those different notions and benchmarks can lead to different outcomes. We will further discuss this in detail in a separate chapter, although primarily in regard to sustainability reporting. On the other hand, a common feature can be distinguished: information is considered material if its omission or misstatement could influence decision-making.

21 NFRD envisaged that it can be published within management report or as a separate report.

22 Accounting Directive, Art. 2(16).

23 Marco Fasan, Chiara Mio, „Fostering Stakeholder Engagement: The Role of Materiality Disclosure in Integrated Reporting“, *Business Strategy and Environment*, Vol. 26, Nr. 3/2017, 290.

III Materiality Concepts in Non-Financial/Sustainability Reporting

1. Sustainability Reporting Standards: Path to Standardisation of Corporate Reporting in the EU (ESRS)

The EU was at the forefront of introducing mandatory sustainability reporting with the adoption of the NFRD in 2014, which subsequently shaped the sustainability reporting landscape. Before then, only a limited number of large companies in the EU were disclosing non-financial information. Disclosure of nonfinancial, i.e. sustainability information, was largely left to the discretion of the companies. This could potentially lead to a situation where companies present themselves as socially responsible entities, whereas these reports could be used not as a tool to disclose material information but as a marketing tool to improve the image and reputation of the companies in question.

Some of the initial issues, inherited from the period when non-financial reporting was voluntary – remained. While an important step, in some respects, the NFRD have been largely unsuccessful in improving the disclosure of non-financial information. Namely, some companies did not disclose non-financial information at all or did not disclose (all) material information. The information provided was neither comparable nor sufficiently reliable, even after mandatory reporting was introduced.[24] Companies were allowed to choose between different existing standards, which contributed to even more divergence. Sometimes, they even combined two or more frameworks (mostly the GRI and one of the alternative standards/frameworks; see Table 1 below), some of which used different concepts of materiality. Companies used a wide variety of ESG metrics and indicators, which became a major challenge in terms of comparability and effectiveness.[25] The use of different approaches to materiality is problematic because the use of divergent approaches to materiality can lead to confusion and can cause users to draw the wrong conclusions,[26] it can lead to regulatory arbitrage, 'greenwashing',

24 CSRD Impact assessment, 8.

25 Laura Iozzelli, María del Carmen Sandoval Velasco, „Mandatory or Voluntary? The hybrid nature of sustainability disclosure in the EU's Corporate Sustainability Reporting Directive (CSRD)", Robert Schuman Centre for Advanced Studies, Florence School of Banking and Finance, Policy Paper, RSC PP 2023/08, available at: *https://fbf.eui.eu/publication/mandatory-or-voluntary-the-hybrid-nature-of-sustainability-disclosure-in-the-eus-corporate-sustainability-reporting-directive-csrd/*, 10. 5. 2024, 7.

26 Hervé Stolowy, Luc Paugam, „Sustainability reporting: is convergence possible?", *Accounting in Europe*, Vol. 20, Nr. 2/2023, 159; Sveinung Jørgensen, Aksel Mjøs, Lars Jacob Tynes Pedersen, „Sustainability reporting and approaches to materiality: tensions and potential resolutions", *Management and Policy Journal*, Vol. 13, Nr. 2/2022, 346.

and ultimately result in 'race to the bottom'.[27] When using multiple frameworks, it is desirable to at least clearly communicate which concept of materiality is used, which was not always the case and which is a source of confusion and difficulty in terms of reliability and comparability.[28] Even when material information was disclosed, users faced difficulties in finding and exploiting the information.[29] Therefore, fragmentation, or better said, lack of standardisation of sustainability reporting, significantly contributed to the lack of comparability, consistency, and reliability.

EU tried to address this issue by drafting non-binding standards (in 2017)[30] and additional guidelines on reporting climate-related information (in 2019).[31] However, the use of these non-binding standards did not have a major impact on improving the comparability, consistency, and relevance of the information disclosed. This is the main reason why the EU called for further development of reporting requirements and considered the development of the European reporting standards. This task was assigned to the European Financial Reporting Advisory Group (EFRAG). From the very beginning, the goal was to align new standards with existing standards and frameworks for sustainability reporting, in particular those developed by leading actors: the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB, now consolidated into the IFRS Foundation), the International Integrated Reporting Council (IIRC), the International Accounting Standards Board (IASB), the Task Force on Climate-related Financial Disclosures (TCDF), the Carbon Standards Board and the CDP (formerly known as the Carbon Disclosure Project).[32] It is not a coincidence that the EU picked these standards. Some of these were amongst the most used standards, as can be seen below:

27 Wolf Georg Ringe, „Investor-led Sustainability in Corporate Governance", Law Working Paper No 615/2021, available at: *https://www.ecgi.global/sites/default/files/working_papers/documents/ringefinal.pdf*, 20. 4. 2024, 31.

28 S. Jørgensen, A. Mjøs, L. Jacob Tynes Pedersen, 346–347.

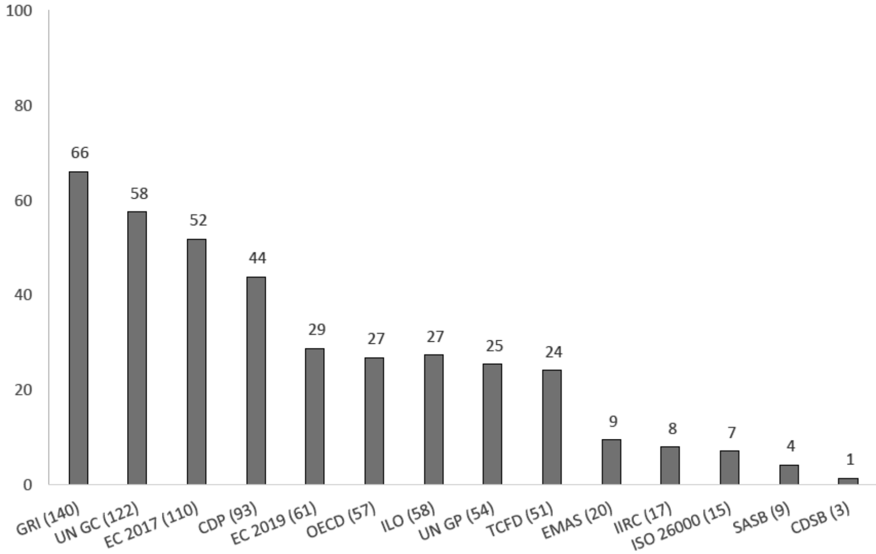
29 *Commission staff working document impact assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting {COM(2021) 189 final} – {SEC(2021) 164 final} – {SWD(2021) 151 final}*, 8.

30 Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information) C/2017/4234.

31 Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490.

32 CSRD, Rec. 43.

Table 1: Reporting framework used for non-financial statements (%).
Source: NFRD Study, 108.[33]



The EU Commission emphasised that Union standards should particularly consider standards developed by the International Financial Reporting Standards Foundation and should contribute to the convergence of standards at the global level by supporting the International Sustainability Standards Board (ISSB).[34] Furthermore, standards should reduce the risk of inconsistent reporting requirements for companies that operate globally by integrating global baseline standards by the ISSB.[35]

EFRAG submitted draft standards in November 2022 after public consultation. On July 31, 2023, the Commission adopted draft standards, although with some modifications. The first set of the ESRS standards is made up of 12 standards, classified as *cross-cutting*,[36] *topical*,[37] and *sector-specific*.[38] Cross-cutting standards and topical standards are sector-agnostic,

33 According to data, companies do not rely on single framework in full. Therefore, high numbers in the figure. NFRD Study, 109.

34 CSRD, Rec. 43.

35 CSRD, Rec. 43.

36 ESRS 1 General Requirements and ESRS 2 General Disclosure.

37 Divided into *environmental* (ESRS E1 climate change, ESRS E2 pollution, ESRS E3 water and marine resources, ESRS E4 biodiversity and ecosystems, ESRS E5 resource use and circular economy), *social* (ESRS S1 own workforce, ESRS S2 workers in the value chain, S3 affected communities, ESRS S4 consumers and end-users), and *governance* (ESRS G1 business conduct) pillar.

38 *https://www.efrag.org/lab6*, 10. 5. 2024.

which means that they are applicable to all undertakings regardless of sector. The final date for the adoption of sector-specific and topical standards has not yet been decided.[39]

The first version of the ESRS standards was far more ambitious. Essentially, in comparison to the first version of the ESRS, the Commission decided to significantly reduce reporting requirements and opt for a more balanced approach in comparison to more far-reaching requirements.[40] To mention some major amendments. Firstly, the Commission introduced additional phase-in provisions for more reporting requirements. This was primarily done in order to give companies, particularly smaller companies, more time to adjust to reporting requirements.[41] Secondly, in previous versions of the ESRS, materiality was presumed, meaning that certain data points were inherently material to all companies. This was seen as overly rigid and burdensome, as companies were required to report on these regardless of the materiality assessment. Following the amendments, this presumption has been removed, and companies have been given more flexibility to decide what information is relevant, i.e. more standards are now subject to materiality assessment rather than being mandatory as was previously the case.[42]

What is very peculiar is that, compared to the adoption of the IFRS in the EU, there has not been as much (academic) discussion about the adoption of the ESRS standards. In other words, there was not much discussion on whether it would make more sense to adopt some of the existing standards developed by internationally recognised organisations rather than to develop their own set of standards. It seems that, unlike when the EU decided to adopt IFRS, now the EU has decided to become a 'standard giver' instead of a 'standard taker'.[43] The EU considered that existing standards are not suitable for satisfying the needs for sustainability reporting in the EU. According to the EU, the absence of unique reporting standards would lead to higher cost complexity for cross-border operations and could undermine the right of establishment, free movement of capital, comparability of information, etc.[44] One of the reasons probably lies in the fact that EU has no control over

39 *https://www.efrag.org/lab5*, 10. 5. 2024.

40 See more on reducing reporting requirements for companies in Speech by President von der Leyen at the European Parliament Plenary on the preparation of the European Council meeting of 23–24 March 2023, European Commission, March 15, 2023, available at: *https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_23_1672*, 1. 5. 2024.

41 European Commission, Questions and Answers on the Adoption of European Sustainability Reporting Standards, available at: *https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_4043*, 1. 5. 2024.

42 *Ibid*.

43 Pierre-Henri Conac, „Sustainable Corporate Governance in the EU: Reasonable Global Ambitions?", *RED*, Vol. 4, Nr. 1/2022, 116.

44 CSRD, Recital 16, 38.

non-EU bodies, such as ISSB.[45] In order to reduce administrative burden, the EU announced that the Union standards would be aligned as much as possible with some of the existing leading standards mentioned above, which should be enough to achieve a satisfactory level of convergence. Adoption of the EU standards might have exactly the opposite effect on convergence and harmonisation, thus leading to higher costs imposed on companies and users (especially global investors).[46] In particular, there are still differences between the ESRS and other standards, among others, in terms of the materiality approach adopted. For example, unlike the ESRS, the SASB framework (developed by the IFRS Foundation) does not rely on double materiality, which could have a particular impact on the EU's attractiveness to international investors.[47]

2. Single vs. Double Materiality

At the centre of the discussion of materiality lies the concept adopted within the relevant framework, which is of key importance when delimiting the scope of the disclosure. In this light, two main concepts of materiality in sustainability reporting are *single* and *double materiality.*

Single materiality considers primarily the financial impact of climate and other ESG risks on enterprise value (*outside-in* perspective). This concept is more oriented towards investors, in line with the view that investors primarily consider financial performance, although not ignoring the fact that investors increasingly recognise the financial relevance of ESG issues.[48] The decision of the EU Commission to use the term 'sustainability information' is, in fact, a recognition of the (financial) relevance that sustainability information has.[49] The CSRD itself underlines that information published in line with the (earlier) NFRD does not have (only) a non-financial nature and that *it can affect enterprise value*. Non-financial (sustainability) reporting is,

45 Jukka T. Mähönen, Vera Palea, „Analyzing double materiality through the lense of the European political constitution: Implications for interoperability and standards-setting", Nordic & European Company Law, LSN Research Paper Series, No. 24–03, available at: *https://ssrn.com/abstract=4731089*, 20. 4. 2024, 18. On this issue in context of financial reporting *see* Giovanni Strampelli, „The Limits of Including Financial Disclosure Rules in a European Capital Markets Code", *Regulating EU Capital Markets Union, Volume I, Fundamentals of a European Code* (Ed. Rüdiger Veil), Oxford, 2024, 393–397.

46 Gaia Balp, Giovanni Strampelli, „Institutional Investors as the Primary Users of Sustainability Reporting", available at: *https://ssrn.com/abstract=4495602*, 1. 4. 2024, 6.

47 *Ibid*.

48 Aline Darbellay, Yanick Caballero Cuevas, „The Materiality of Sustainability Information under Capital Markets Law", *Schweizerische Zeitschrift für Wirtschafts– und Finanzmarkt recht*, Vol. 95, Nr. 1/2023, 46; R. Jebe, 647.

49 CSRD, recital 8.

therefore, not only functional for the pursuit of moral objectives but rather essential for investors and other stakeholders.[50]

The division between financial and non-financial information is far from clear since they are not impermeable to each other.[51] Some authors recognise three different types of information in sustainability reports: ESG information that is financial in nature and is included in the financial report; information that is not included in the financial statement but is likely to affect the value of the company and is relevant to investors; finally, information that affects the environment and community, but theoretically is not relevant for value and performance of the firm.[52] Therefore, financial and non-financial information can overlap, and sustainability information indeed can include information that has not only financial but also social impact, i.e. impact on wider society.[53]

A single materiality perspective, focused on the financial impact, is a key characteristic of the ISSB – IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information:

> 'An entity shall disclose material information about sustainability-related risks and opportunities that could reasonably be expected to affect the company's prospects.
>
> In the context of sustainability-related financial disclosures, information is material if omitting, misstating, or obscuring that information could reasonably be expected to influence decisions that primary users of general purpose financial reports make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and provide information about a specific reporting entity.'[54]

The single materiality was also followed by the TCDF, which focused on the financial implications of climate change.[55] The standards aim to provide investors and companies with the information necessary to consider strategies and capital allocation in light of the economic impact of climate change.[56]

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50 G. Balp, G. Strampelli, 2.

51 *Ibid.*, 10.

52 *Ibid.*

53 *See* A. Darbellay, Y. Caballero Cuevas, 48; G. Balp, G. Strampelli, 10.

54 *https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s1-general-requirements.html/content/dam/ifrs/publications/html-standards-issb/english/2023/issued/issbs1/*, 1. 5. 2024.

55 IFRS Foundation took over the monitoring of the companies' climate-related disclosure and TCDF was disbanded.

56 *See https://www.fsb-tcfd.org/publications/*, 1. 5. 2024.

The OECD Principles of Corporate Governance (revised 2023) seem not to delve into the discussion of single and double materiality. However, the OECD Principles do, in fact, strive towards a single materiality approach. This is evidenced by the fact that an outside-in perspective is evident in several instances within the OECD principles. The Principles underline the consideration of material sustainability issues in financial estimates, which is typical for a single materiality, as it is envisaged that these risks 'have had or are likely to have a *material impact on a company's business*'.[57] Furthermore, the principles state that material sustainability-related information is one that could influence the value and ability to generate revenue and long-term growth.[58] In light of the aforementioned considerations, it seems appropriate to conclude that the OECD Principles adopt a single materiality approach.

Although the IOSCO, in its Report on Sustainability-related Issuer Disclosures, presents both single and double materiality, it appears that the choice between these two options is left to the discretion of the companies.[59] However, this organisation ended up endorsing the ISSB Standards, which adopt single materiality.[60] IOSCO's endorsement is of great significance as IOSCO has been very influential – a driving force – in promoting ESG principles globally. IOSCO's endorsement calls on 130 member jurisdictions, which regulate over 95% of the world's financial markets, to adopt, apply or otherwise be guided by the ISSB Standards.[61] Recognizing the diversity of arrangements across jurisdictions regarding international standards, IOSCO acknowledges that the ISSB Standards can serve as an 'effective and proportionate global framework'.[62] While achieving consensus on double materiality across 150 jurisdictions remains a considerable challenge, the EU is uniquely positioned to introduce its own set of standards and push double

57 OECD Principles of Corporate Governance 2023, VI.A.3 Disclosure of sustainability matters, financial reporting and other corporate information should be connected.

58 OECD Principles of Corporate Governance 2023, VI.A.1. Sustainability-related information could be considered material if it can reasonably be expected to influence an investor's assessment of a company's value, investment or voting decisions.

59 A. Darbellay, Y. Caballero Cuevas, 47.

60 IOSCO endorsement assessment of the ISSB Standards for sustainability-related disclosures, available at: *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD741.pdf*, 1. 5. 2024, 1.

61 See IOSCO endorsement of the ISSB Standards for sustainability-related disclosure, available at: *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD741-Endorsement-Decision.pdf*, 1. 5. 2024; Keynote Speech of Jean-Paul Servais, FSMA and IOSCO Board Chair, Sustainable, Digital and Non-Bank Finance: IOSCO's achievements and perspectives, available at: *https://www.iosco.org/library/speeches/pdf/20230913-Jean-Paul-Servais.pdf*, 1. 5. 2024.

62 IOSCO endorsement assessment of the ISSB Standards for sustainability-related disclosures, 8.

materiality, given the relatively smaller number of jurisdictions it oversees compared to the IOSCO.

Double materiality requires disclosure of both the impact of sustainability issues on the companies' value and impact of company's activity on people and the environment. As such, it goes beyond the financial impact that ESG and climate risks have on the value of a company, employing both an '*outside in*' and an '*inside out*' perspective. Double materiality is one of the key concepts of the CSRD (and ESRS). Contrary to the perception that this concept was first introduced by the CSRD, the reality is that it had already been in existence in the NFRD, although this may not have been sufficiently emphasised or made clear. Despite the fact that some companies applied the principle of dual materiality, the concept was not clear to all companies within the scope and, according to the study, was even confusing to some stakeholders.[63] Some clarity was added by the non-binding Guidelines on non-financial reporting in 2017, but also by the Supplement on reporting climate-related information from 2019, clarifying that the NFRD has double materiality perspective.[64] This supplement further clarifies that reference to company 'development, performance [and] position' indicates *financial* materiality, while reference to 'impact of [company'] activities' indicates environmental and *social* materiality.[65]

Double materiality in the CSRD consists of *financial materiality* (*outside-in* perspective – how sustainability issues affect company) and *impact materiality* (*inside-out* perspective – how company activity impacts people or the environment). Companies will have to report if the topic satisfies criteria *either* from an *impact* or *financial* perspective, *or both*.[66]

From *financial materiality* aspect, information is material if it '...could reasonably be expected to influence decisions that they make on the basis of the undertaking's sustainability statement...' Sustainability matter is material from *financial perspective* if '...it triggers or could reasonably be expected to trigger material financial effects on the undertaking.'

This will be the case when matter generates risks or opportunities that have or could reasonably be expected to have a material influence on development, financial position, financial performance, cash flows, access to finance, or cost of capital over the short, medium, or long term. It is further explained that the matter is not limited to matters within the control of the undertaking, but also to risks and opportunities attributable to business

63 NFRD Study, 102–103.

64 NFRD Study, 101.

65 NFRD Study, 11; Guidelines on non-financial reporting: Supplement on reporting climate-related information (2019/C 209/01), 2.2 Materiality.

66 CSRD, Rec. 29; ESRS regulation, 3.2 Material matters and materiality of information.

relationships beyond the scope of consolidation used in the preparation of financial statements.[67]

Sustainability matter according to the ESRS is material when it pertains to actual or potential, positive or negative impact on people or environment over short, medium or long term. Impacts are not limited to the operations in the value chain of the companies, but also to the operations up and downstream, including through products and services and business relationships (in the up or downstream value chain, and not limited only to direct contract relationships).[68]

However, some topics are mandatory *regardless of materiality*. Namely, the 'comply or explain' principle on which the NFRD was based is almost entirely replaced in the CSRD, which introduced mandatory reporting requirements subject to materiality analysis. Replacing the principle of 'comply or explain' with a materiality assessment does not mean that companies are required to report on all sustainability-related issues, only those that are material to the entity – if information is not considered material after a materiality assessment, it can be omitted.[69] The exception is reporting according to the ESRS 2 General Disclosure, in which case – regardless of the outcome of the assessment – information must be disclosed.

Double materiality, that is, financial and impact materiality, is not universally accepted within existing (leading) sustainability reporting frameworks. In the current landscape, apart from the CSRD/ESRS, double materiality is adopted in the GRI standards (2.1 Impact):[70]

> 'In the GRI Standards, impact refers to the *effect an organization has* or *could have* on the economy, environment, and people, including effects on their human rights, as a result of the organization's activities or business relationships. The impacts can be actual or potential, negative or positive, short-term or long-term, intended or unintended, and reversible or irreversible. These impacts indicate the organization's contribution, negative or positive, to sustainable development.'

Probably the most prominent representative of *single materiality* is ISSB, and it was criticized for not adopting double materiality. Some authors consider that ISSB failed largely to deliver high-quality and globally comparable

67 ESRS, 2.5 Financial materiality, para. 48–49.

68 ESRS, 3.4 Impact materiality.

69 Alexandros Seretakis, Félix E. Mezzanotte, „Corporate Sustainability Reporting and Blockchain", *European Company Law Journal*, Vol. 20, Nr. 5/2023, 99.

70 Standards are available free of charge at: *https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/*, 15. 5. 2024.

information for investors, and is also limited in scope of information.[71] One of the main criticisms of single materiality, i.e. financial impact materiality, is that sustainability issues have wider societal and planetary impacts.[72] This could potentially lead to an outcome where stakeholder interests are neglected since impact is only limited to financial, also leading to scenario in which investors' information needs are not entirely satisfied. Namely, investors' information needs have changed over time, and although they are still mainly interested in how ESG risks affect their investment, i.e. enterprise value, they are increasingly interested also in the social impact perspective. Single materiality ignores financially immaterial issues which can have far-reaching consequences, but also needs of investors to some extent.[73] Furthermore, as we mentioned above, materiality is a dynamic concept and is time sensitive. Consequently, even if information is not financially material at the time of reporting, it has the potential to become financially material at a later date, therefore it is relevant also for investors.[74] Eventually, positive or negative impact will translate into opportunities and financially material risks for the company.[75] It is also worth mentioning that it is not always easy to separate information that affects the value and performance of the company from that which is related to its impact on society, especially given that sustainability and financial risks are likely to overlap at some point.[76]

Conversely, the concept of *double materiality* extends beyond the realm of financial impact, offering insights that are pertinent not only to stakeholders but also to investors. However, double materiality approach could lead to higher administrative cost considering number of data points (at the moment, there are around 1000 data points).[77] This could lead to information overload. Another issue, although not specific to double materiality, is that the presence of numerous data points and stakeholders

71 Nathan de Arriba-Sellier, „The ISSB's new standards: breaking ground or low hanging fruits?", ECGI Blog, 13 July 2023, available at: *https://www.ecgi.global/publications/blog/the-issbs-new-standards-breaking-ground-or-low-hanging-fruits*, 10. 5. 2024.

72 Max Göttsche, Frank Schiemann, Florian Habermann, Theresa Spandel, Max Tetteroo, „Striking a balance: The importance of double materiality in sustainability reporting", ECGI Blog, 26 September 2023, available at: *https://www.ecgi.global/publications/blog/striking-a-balance-the-importance-of-double-materiality-in-sustainability*, 1. 5. 2024.

73 M. Göttsche *et al.*

74 GRI, 12.

75 Giovanni Strampelli, „ESG, Sustainability Disclosure, and Institutional Investor Stewardship", *Washington and Lee Law Review Online*, Vol. 81, Nr. 6/2024b, available at: *https://scholarlycommons.law.wlu.edu/wlulr-online/vol81/iss6/2*, 1. 5. 2024, 416.

76 G. Balp, G. Strampelli, 13.

77 Draft list of ESRS data points available at: *https://efrag.sharefile.com/share/view/s1a12c193b86d406e90b1bcd7b6bb8f6f/fo37c90b-9d9b-4432-a76b-27760cfcc01b*, 1. 4. 2024.

makes it more challenging to address the dynamic nature of materiality. This makes data identification and processing more demanding both from companies' and recipients' perspective. The article published in Le Monde by Emmanuel Faber (President of the ISSB) attracted a lot of attention.[78] In this article, Faber claims that the concept of double materiality is actually quite simplistic, maintaining the triple illusion and producing dangerous blind spots.[79] Finally, in the context of the ESRS, concerns may be raised regarding comparability and interoperability with other standards. This is particularly important for investors and for companies operating in multiple jurisdictions.

This chapter demonstrated that the debate surrounding the merits of single versus double materiality is far from being concluded. Currently, there is a clear dichotomy between those who advocate for double materiality and those who support single materiality. The concept of single materiality continues to enjoy the support of major global players in the field of standard-setting. Double materiality will be dominant in the EU after the ESRS enters into force, while the single materiality approach is still dominant, from a geographical point of view, in the USA, Argentina, Canada, and Switzerland.[80]

3. Material to Whom? – Stakeholder or (Reasonable) Investor Lenses as a Benchmark?

One of the key issues, as mentioned above, when deciding which information to disclose is to define the materiality benchmark, which should lead to delimiting the scope of disclosure. Although it is not always easy to navigate in current landscape as both material and audience scope vary, two main streams in defining the relevant benchmark for determining materiality are investor-oriented and stakeholder-oriented approach. This is not surprising as standards are built on different concepts of materiality primarily as a consequence of whether standards are intended to inform investors or a broader group of stakeholders.[81] This should not lead to the conclusion

78 Emmanuel Faber, Comptabilité d'entreprise: „Exiger que la matérialité s'étende au-delà du domaine économique est en réalité simpliste", *Le Monde*, 10. 10. 2023, available at: *https://www.lemonde.fr/idees/article/2023/10/10/comptabilite-d-entreprise-exiger-que-la-materialite-s-etende-au-dela-du-domaine-economique-est-en-realite-simpliste_6193607_3232.html*, 1. 5. 2024.

79 'Evidente de prime abord, cette conception est en réalité simpliste. Devenue le cri de ralliement de ceux qui rejettent en bloc la matérialité ordinaire des marchés financiers, désormais réputée "simple", elle entretient une triple illusion et porte un angle mort dangereux.'

80 CSRD Impact Study, 192–193; for Switzerland and USA approach *see* A. Darbellay, Y. Caballero Cuevas.

81 *https://www.globalreporting.org/media/r2oojx53/gri-perspective-the-materiality-madness.pdf*, 1. 5. 2024, 3.

that by deciding the benchmark we have defined users, as reports can and are used by a wider group than the ones taken as benchmark. However, it is useful for identifying the *primary users* whose needs a particular reporting framework is designed to meet, rather than all of the potential users.

To begin with, as we did with the definitions of materiality above, we will briefly present the most commonly used benchmarks that are referred to in the leading sustainability reporting standards, financial reporting standards and principles.

Standards that take a *single, i.e. financial impact*, approach to materiality are more *investor-oriented*. This is a logical consequence of their primary focus on the financial impact and their aim to provide investors with the information necessary to make informed decisions. In this vein, for instance, IFRS S1, same as IFRS standards, mention:

'*primary users of general-purpose financial reports...* to understand the effects of sustainability-related risks and opportunities on the cash flows, its access to finance, and the cost of capital in the short, medium, and long term.'

Although it might seem simple to answer that investors are primary users for this purpose, this concept needs further clarification. In the context of *financial reporting*, stakeholders expressed concern that the use of the term 'users' was open to wide interpretation in the absence of a clear description of the characteristics of users.[82] IAS 1 clarified that primary users are existing and potential investors, lenders, and other creditors, while remarking that such users have *reasonable knowledge* of business and economic activities, thus presuming that users are *reasonable experts*; nonetheless, more knowledgeable and powerful users are not primary users since they are able to require additional information directly from reporting entities.[83]

Apart from IFRS sustainability standards, investor-oriented approach is also supported by OECD Principles of corporate governance 2023.[84] Integrated reporting (IR) framework, which combines both financial and non-financial information in single document, has *investor lenses* – it is specified that 'the intended users of IR [integrated reporting] are the providers of financial capital, and the issues must be material to them.'[85] Lastly, the ESRS, when it comes to assessing *financial impact*, also uses lenses of providers of

82 IFRS, Definition of Material: Amendments to IAS 1 and IAS 8, 2.

83 G. Strampelli (2024a), 402.

84 OECD Principles of Corporate Governance 2023, VI. Sustainability and Resilience.

85 C. Mosca, C. Picciau, 188. According to some authors, stakeholders are also part of the materiality assessment process, as the IR framework states that stakeholders provide insight into issues that affect the value creation of the company, so companies are expected to take their interests into account to some extent but does not provide guidance how reconcile and balance interest of investors and other stakeholders. *See* R. Jebe, 663.

capital: identification of information considered material for '*primary users of general-purpose financial reports in making decision relating to providing resources to the entity*'.[86] This makes sense since the ESRS perceives the scope of financial materiality within sustainability reporting as expansion of scope of materiality used in determining information for financial statements of reporting entity.[87]

In terms of the qualifications or characteristics of the investor to which sustainability standards refer, there is not much detail provided. It seems that the concept of the reasonable/rational investor is at the same time a generally well established concept, but also quite 'vague and slippery'.[88] Firstly, there is a dilemma whether reasonable investor is average person or someone with specialist knowledge.[89] Secondly, some authors rightfully reflect on whether there are reasons to examine if the concept of the prototypical rational investor from the perspective of economic rationality is still a valid concept, or needs some 'fine-tuning' in the ESG era, in particular if some non-economic values and irrational moods that characterise the 'new rational investor' need to be taken into account.[90] It should also be noted that while investors have become more aware of corporate sustainability issues, the notion of a rational investor does not necessarily coincide with the notion of a socially responsible rational investor.[91] Therefore, what may be material to an investor with a preference for socially responsible investment does not necessarily have to be material to the average investor. However, we are not implying that only investors interested in socially responsible investments are demanding ESG information, thus that this group should serve as benchmark. On the contrary, mainstream investors are also becoming increasingly interested in ESG issues and are therefore demanding more ESG information. This is confirmed by increase of market share of socially responsible investing, but also in public statements of mainstream investors.[92] Therefore, standards could probably

86 ESRS, 3.5, Financial materiality.

87 ESRS, 3.5, Financial materiality.

88 See Marco Ventoruzzo, „Reflections on the notion of reasonable investor", *Rivista delle società*, Vol. 64, Nr. 5–6/2019, 1296 *et seqq*.

89 G. Strampelli (2024a), 401–402.

90 Aisha I. Saad, Diane Strauss, „The New „Reasonable Investor" and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation", *Berkeley Business Law Journal*, Vol. 17, Nr. 2/2020, 411.

91 Michael Garellek, „Less is not more: Non-Financial Disclosures and the Socially Responsible Investor", *Finance durable et droit: perspectives comparées* (eds. Hugues Bouthinon-Dumas, Bénédicte François, Anne-Catherine Muller), Paris, 2020, 199.

92 Aisha I. Saad, Diane Strauss, „The New „Reasonable Investor" and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation", *Berkeley Business Law Journal*, Vol. 17, Nr. 2/2020, 412–418.

clarify the concept of the reasonable investor in this respect. The concept should not be limited to investors interested in sustainable investments but should consider the changing concept of the prototypical investor.

The principal advantage of an investor-oriented approach is that it employs a single, relatively clear, precise, and well-established standard of assessment. It is clear whose needs are to be satisfied, although there are some open questions, as we mentioned above. Furthermore, given that investors are also increasingly interested in not only how ESG issues affect firms' value, but also in the social impact of companies' activities, there is a case to be made for using investor lenses even in case of double materiality. Investors (institutional investors in particular) can be seen as primary users of sustainability reporting.[93] Another argument in favour of adopting an investor perspective is that institutional investors, in particular, have significant potential to assist in pursuing sustainability goals.[94] The observation that standards which adopt an investor perspective typically focus on a single materiality, thereby limiting their scope to financial impact, is a valid criticism. However, this critique should be attributed to single materiality rather than the use of an investor perspective *per se*.

At the other end of the benchmarking spectrum is the *stakeholder* approach. Unlike single materiality and investor-oriented frameworks which primarily aim to provide decision-useful information about sustainability related risks and opportunities necessary for providers of resources, stakeholder approach is more far-reaching. Stakeholder approach is oriented both towards providing information about financial and impact on society and environment as well.

For instance (but not limited to), this approach is adopted by the GRI and CSRD.[95] The GRI does not have clear definition of benchmark used, but it is clear from its provisions that it has *stakeholder* approach. Furthermore, it has very broad definition of users as it mentions that reported information can be used by organization in its decision-making, by stakeholders, investors and users other than the organization's stakeholders, such as academics and analysts.[96]

93 G. Balp, G. Strampelli, 7

94 *See* W. G. Ringe.

95 Double materiality is, for example, also supported by Sustainable Finance Disclosure Regulation (*Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector*, *OJ* L 317, 9. 12. 2019); Taxonomy Regulation (*Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088*, *OJ* L 198, 22. 6. 2020).

96 GRI, 7–8.

The CSRD, compared to other existing sustainability reporting frameworks, also seems to have more ambitious goals in terms of information recipients, but also overall goal. It explicitly states that it aims to satisfy a wider group of users. In contrast to the GRI, the CSRD is somewhat more precise in its definition of users, as it identifies two *primary groups* of users whose information needs are to be met. *The first primary group* consists of investors and asset managers. *The second primary group* consists of civil society actors, non-governmental organisations, and social partners.[97] *Other groups of users* might of course also have use and rely on sustainability information but are not recognised as primary users. Although with respect to investors and asset managers, the Directive recognises that they are primarily interested in risk and opportunities that sustainability issues pose for their investment, it underlines that investors and asset managers are not only interested in financial impact, but also in impact of their investments on people and the environment, as we already mentioned before. Given the aforementioned considerations, it is not surprising that the other primary group, stakeholders, is primarily but not exclusively interested in the accountability of companies with regard to their impact on people and the environment.[98]

The ESRS also defines two groups of users within stakeholders. The *first group* is composed of primary users of general-purpose financial reporting (investors, lenders, other creditors including asset managers, credit institutions, insurance companies). The *second group* includes users of sustainability reports (business partners of the company, trade unions and social partners, civil society and non-governmental organisations, governments, analysts and academics).[99]

The adoption of the stakeholder approach is a consequence of the ambitions of EU and the CSRD, which is to go beyond what non-financial reporting as defined in the NFRD has tried to achieve. The CSRD not only expands the range of users, but it also goes beyond establishing a reporting framework to reduce information asymmetry. It aims to steer companies towards more sustainable behaviour.[100] In addition, it does not only deal with the company's own operations that could have an impact, but also with the operations within its value chain and established business relationships, and even applies to some companies outside the EU.[101] Adoption of this approach can also be associated with a lively debate about corporate purpose

97 CSRD, Rec. 9.

98 CSRD, Rec. 9.

99 ESRS, 3.1 Stakeholders and their relevance to the materiality assessment process.

100 *See* in more detail: G. Strampelli (2024b), 408–409.

101 CSRD, Rec. 18, 31; Art. 19a.

and shareholder primacy *vs* stakeholder approach.[102] Some authors identify consistency of sustainability disclosure with transition to multi-stakeholder model.[103]

A *stakeholder-oriented* approach raises a number of key issues that require further consideration. Indeed, there are some lessons to be learnt from discussion on stakeholder approach. Regarding the stakeholder approach to sustainability reporting, the question remains: whose interests are being represented and whether there are more dominant interests, i.e. whose interests should be prioritised in case of conflict which is probable to happen.[104] One of the key issues is to identify the relevant groups, as not all groups are relevant. It is evident that this would not be an easy task, given the extensive and diverse definition of the groups in question. According to the ESRS, engagement with affected stakeholders is central to materiality assessment (and due diligence process).[105] Therefore, the role of the stakeholders is not merely passive, but rather it is an active one. This implies that stakeholders are to be engaged in the materiality assessment process, rather than merely acting as passive recipients of information.

Another related issue is the fact that there is *no single standard of assessment* – information may be material to some stakeholders but not to others, and it is not always easy to say whether it is material or not in that case.[106] The problem is also that this approach could potentially lead to

102 On corporate purpose discussion *see* for example: Klaus J. Hopt, „Corporate Purpose and Stakeholder Value – Historical, Economic and Comparative Law Remarks on the Current Debate, Legislative Options and Enforcement Problems", ECGI Law Working Paper, No. 690/2023, available at: *https://ssrn.com/abstract=4390119*, 1. 4. 2024; Guido Ferrarini, „Redefining Corporate Purpose: Sustainability as a Game Changer", *Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets* (eds. Danny Busch, Guido Ferrarini, Seraina Grünewald), London, 2021, 85–150; Paul Davies, „Shareholder Voice and Corporate Purpose: The Purposeless of Mandatory Corporate Purpose Statements", ECGI Law Working Paper, No. 666/2022, available at: *https://ssrn.com/abstract=4285770*, 1. 4. 2024; Colin Mayer, „The Governance of Corporate Purpose", ECGI Law Working Paper, No. 609/2021, available at: *http://ssrn.com/abstract_id=3928613*, 1. 4. 2024, 1–13; Holger Fleischer, „Corporate Purpose: A Management Concept and its Implications for Company Law", *European Company and Financial Law Review*, Vol. 18, Nr. 2/2021, 161–189.

103 See also G. Balp, G. Strampelli, 15.

104 Milena Mitrović, „Dužnosti direktora u održivom korporativnom upravljanju", *Pravo i privreda*, Vol. 61, Nr. 3/2023, 856–857.

105 *Affected stakeholders* are individuals or groups whose interests are or could be affected, whereas impact can be both positive and negative. Furthermore, impact can be consequence of companies', but also activities of its direct or indirect business relationship across value chain. ESRS, 3.1 Stakeholders and their relevance to the materiality assessment process, 22.

106 M. Fasan, C. Mio, 290.

information overload, as the aim is to satisfy different groups of users who have different needs, and the publication of all available information is by no means appropriate.

The biggest concern is however *accountability*, as 'having too many masters, means accountability to none'.[107] It can be argued that while stakeholderism may appear to be an appealing approach in the context of sustainability issues and the necessity for accountability and the adoption of this approach, in practice, it may not deliver the expected results. Some scholars argue that stakeholder theory might inadvertently foster insulation and reduce accountability, with adverse effects on reform.[108] This could also lead to an increase in litigation. The presence of multiple groups with conflicting interests could result in some of them perceiving that their interests have not been adequately considered.

IV Conclusion

Materiality plays pivotal role in determining which information and what amount of information needs to be disclosed, both in financial and non-financial/sustainability reporting. Despite the progress made, ESG reporting continues to face significant difficulties and is underperforming in meeting its objectives. The different notions of materiality that currently exist in reporting frameworks is one of the key issues in the rise of sustainability reporting. At present, international sustainability reporting frameworks are still fragmented, with different notions of materiality employed. Overcoming this fragmentation is particularly desirable as it is problematic for both investors and companies that do business globally. This could lead to significant issues that could lead to greenwashing, cause problems with comparability, and result in higher costs for companies and for users of information. Therefore, further improvements and above all convergence of standards are both possible and desirable.

Two main concepts of materiality in sustainability reporting are single and double materiality. *Single materiality* focuses on financial impact of ESG issues on company's value, also known as 'outside-in' perspective. Globally speaking, this concept is still leading concept since it is present in leading global reporting standards, such as ISSB. Main feature of this concept is that it is limited to financial impact and is more investor-oriented. Principal problem of this approach is that it is limited to financial impact and that it might not satisfy even information needs of its primary users – investors.

107 C. Mosca, C. Picciau, 180.

108 *See* also Lucian A. Bebchuk, Roberto Tallarita, „The Illusory Promise of Stakeholder Governance“, *Cornell Law Review*, Vol. 106, Nr. 91/2020, 164 *et seqq*.

Namely, even mainstream investors are more and more interested in ESG issues that do not only affect enterprise value. Furthermore, it is not always simple to delimitate financial from social impact, as what eventually social impacts can also translate to financial risks. This approach also ignores to some extent wider implications of ESG issues on environment and society as whole. Main advantage of this approach stems from the fact that single materiality takes investor needs as benchmark. Therefore, we have clear and to great extent precise standard of assessment and it is also clear whose needs are to be satisfied.

Double materiality in the CSRD consists of financial materiality (outside-in perspective – how sustainability issues affect company) and impact materiality (inside-out perspective – how company activity impacts people or the environment). Companies will have to report if the topic satisfies criteria either from an impact or financial perspective, or both. Double materiality came into spotlight, although it was in existence already with the Non-financial Reporting Directive (NFRD), with adoption of the Corporate Sustainability Reporting Directive (CSRD) and the European Sustainability Reporting Standards (ESRS). It is also present in some other frameworks, for instance the Global Reporting Initiative (GRI). Double materiality concept is, comparing to single materiality, more ambitious concept in several aspects. Firstly, it goes beyond financial impact and deals also with social impact. Furthermore, it aims to satisfy information needs of wider audience, namely stakeholders. Therefore, contrary to investor-oriented approach adopted in single materiality, double materiality is stakeholder-oriented approach. Finally, the adoption of double materiality and the stakeholder approach is a consequence of the ambitions of the EU and the CSRD to go beyond the establishment of a reporting framework. The CSRD seeks to steer companies towards more sustainable behaviour.

The application of the double materiality approach is usually associated with higher costs. Companies must deal with numerous data points. An important concern is that it makes it difficult for those preparing the report to identify and select the relevant (material) data. It is possible that applying this principle increases the likelihood of information overload. Therefore, from the perspective of both companies and recipients, the process of data identification and processing is more demanding. The fact that double materiality goes hand in hand with a stakeholder approach leads us to several issues. One of the key issues is to identify the relevant groups, as not all groups are relevant. Another is to prioritise, i.e. to balance stakeholder interests when they are in conflict. In addition, there is no single standard of assessment, as double materiality takes stakeholders as a benchmark. This means that there are different groups of users with different needs. Therefore, what is at the same time the greatest advantage is also the greatest concern – accountability. The presence of multiple groups with conflicting interests could lead to the perception by some of these groups that their interests have not been adequately considered, which could lead to litigation and could expose companies and their management to excessive liability risk.

Further improvements and, above all, convergence of standards is possible and certainly highly desirable. At the same time, it is necessary to overcome the problem of the application of different concepts of materiality. There is also a case to be made for a rethink of the benchmarks that are currently in use. We could make a strong case for using investors as a benchmark even in the case of double materiality, provided that the standard is redefined in line with the changing characteristics of investors, as a reflection of the fact that even mainstream investors are increasingly interested in ESG issues and not just from a financial impact perspective.

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