

Materiality in ESG: Navigating Impact, Value, and Regulatory Evolution

A discussion document from the team at
Veridia Carbon



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Introduction

Materiality is the key for meaningful ESG (Environmental, Social, and Governance) disclosure. The definition of what ESG is varies depending on who you are speaking to, what their agenda is and of course the level of real-world involvement they have had with ESG. In simple terms it is a framework that ensures companies focus on what's significant for both their organisation, investors and stakeholders.

The central principle is that ESG materiality is a means to assess which Environmental, Social and Governance factors are most relevant. It allows the prioritisation of topics and concerns according to their financial implications, as well as their broader impact on people and the planet.

Single and Double Materiality

Single Materiality is entirely focused on how ESG factors affect an organisation's financial performance and position. This has been the traditional approach and is centred on what will influence the decisions of 'reasonable investors'. This is of course context dependent and determined by the organisation. Here, ESG data is assessed solely through the prism of enterprise value: what can alter a company's cash flows, asset valuations, or risk profile.

It is important to note that some critics continue to advocate for a focus on financial / single materiality alone, arguing that it preserves clarity, reduces reporting complexity, and safeguards the information most relevant to investors' decision-making needs. This position is not without merit.

Double materiality, however, reflects the growing recognition that organisations operate within, and upon, wider social and ecological systems. This broader approach means organisations must not only evaluate how external ESG factors impact them, but also how their actions impact the environment and society at large. It considers the impact on the organisation, but also of the organisation. As such, double materiality embodies the concept of interdependence, namely the outcomes for an organisation and the outcomes for the broader financial and market ecosystem are linked. In turn this means business success and societal well-being reinforce or undermine each other.

Externalities

Externalities are the unintended consequences, which can be positive or negative, of corporate activities on third parties. The concept of negative and positive externalities has demonstrably moved from the realm of academic curiosity to boardroom reality. Negative externalities include such things as pollution or resource depletion and often result in costs borne by society rather than the organisation or its investors.

ESG materiality requires organisations to 'internalise the externalities' and account for the full social and environmental costs of their operations. Something that has been lacking in the past when we look at environmental disasters and the impact on landscape and resources in prior decades.

This double materiality driven shift underpins a more comprehensive approach to corporate responsibility and risk management.

Value Generation

Materiality in ESG is not simply a compliance exercise, it never has been, it is instead and integral part of generating enterprise value. Strategic ESG management enables organisations to identify, prioritise and act on risks and opportunities that affect long-term growth and stakeholder trust. Academic literature, papers from practicing consultants and firms in the space all point to a strong correlation between effective ESG performance and sustained value creation.

This brings with it benefits such as enhanced reputation, access to capital, innovation, and stakeholder engagement. Critically, ESG actions are not just about avoiding harm - they are about creating new forms of value for the organisation and its broader commercial ecosystem.

ISSB and CSRD

The regulatory landscape is aligning with this expanded view of materiality. The International Sustainability Standards Board (ISSB) exists to develop a globally consistent baseline for sustainability related disclosures.

The ISSB grounds its standards in investor needs and financial materiality, providing actionable information to capital markets. Yet, despite this investor focused view, it signals openness to broader societal expectations as well.

In contrast, the EU's Corporate Sustainability Reporting Directive (CSRD) enshrines double materiality as its reporting norm. This is quite the step forward and greatly welcomed by many. Under the CSRD framework, organisations must systematically disclose how ESG issues influence their business, aka financial materiality, and how their business impacts society and the environment, aka impact materiality.

This affectively applies these dual aspects for comprehensive reporting. What's important to note is that this approach moves ESG, more correctly sustainability, from being an “add-on” to becoming central to modern management and strategy processes.

Navigating Convergence Challenges

Many multinational organisations are now assessing the challenge they face in navigating both the ISSB's financial materiality and the CSRD's double materiality frameworks, especially in light of the EU's 'Omnibus' legislative review. This has energised the efforts of standard setters and preparers alike to find areas of convergence where possible, to streamline disclosures and minimise duplicate reporting.

Nevertheless, significant challenges remain, particularly in harmonising definitions, metrics, and assurance requirements across jurisdictions. In some jurisdictions this framework and the related reporting is mandatory, in others voluntary, yet in others heavily contested. Companies striving for compliance are investing in effective ESG and carbon accounting tools, robust data sets and data systems and seeking to define cross-functional governance. All this while closely monitoring ongoing dialogue between standard setters, legislators, NGOs and the marketplace at large.

In Closing

In the spirit of Robert G. Eccles, materiality in ESG is not simply a "technical detail or regulatory hurdle". ESG is the discipline by which companies make their sustainability journey real, relevant and valuable - both for themselves and for the world they are a part of.

For those of use involved in ESG, we can see the shift in focus from single materiality being sufficient to double materiality becoming the norm, and from ignoring externalities to embedding them in decision making, is a profound and welcome paradigm shift. It is the long overdue recognition that ESG delivers not just compliance, but competitive strategy and enduring societal legitimacy.

About Veridia Carbon

The team at Veridia Carbon take a multi-disciplinary approach to Carbon Accounting , ESG and Sustainability. With a focus on value creation and compliant reporting.

We can provide everything from an informal first discussion on your ESG and Sustainability journey, up to a full scope Net Zero decarbonisation roadmap and execution plan.

Book time with us today to discuss your ESG journey



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