



The independent impact rating agency™

# iSA methodology

November 2022



## Table of Contents

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1.	<b>Introduction</b>	<b>3</b>
2.	<b>Methodology</b>	<b>4</b>
	2.1 Potential negative SDG contributions	5
	2.2 Positive SDG contributions	8
	2.3 The Potential Impact Indicator	9
3.	<b>iSA for private companies</b>	<b>12</b>
4.	<b>Conclusion</b>	<b>13</b>
5.	<b>Useful definitions</b>	<b>12</b>

# 1. Introduction

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This document is confidential.

The objective of this document is to complete impak's impact rating methodology document and further clarify the iSA (impak SDG Alignment) methodology.

The iSA methodology is based on the following core principles:

- Complete and holistic approach: assessing the full picture the impact generated by corporate activities, which comprises positive and negative impacts;
- Materiality: putting positive impacts in relation to the total activities of a company, and selecting negative impacts based on a double materiality approach. Doing this reduces the risk of overstating positive impacts and understating negative impacts;
- Based on internationally-recognized standards: iSA is aligned with many recognized standards. Specifically, our methodology is based on the GRI, SASB standards and mapped to the UN's Sustainable Development Goals as the most commonly accepted typology of impact issues. Also, by using the IMP Norms, now hosted by Impact Frontier, we ensure that stakeholder perspectives are taken into account, which is a pillar of the double materiality approach.
- Objectivity: eliminating subjectivity as much as possible, for example, by systematically referring to international standards and consensus where relevant, as mentioned above;
- Comparability: for an impact assessment to truly be used as a catalyst for change, we believe its methodology should apply to all types of assets and asset classes (private or listed equity, for-profits or nonprofits, bonds, etc.);
- Transparency: by providing the methodology behind our products (iSA and iS<sup>2</sup> analysis) to our clients and a high level of detail to the public, we are challenging the industry's status quo. Going forward, our goal is to gradually and constantly increase the level of transparency.

## 2. Methodology

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One of the core principles of impact analysis is that all economic activities produce negative side effects (externalities) on the environment and people. The first thing that needs to be done is to identify which of the organization's activities work against the attainment of the SDGs, or in other words, are misaligned with the SDGs.

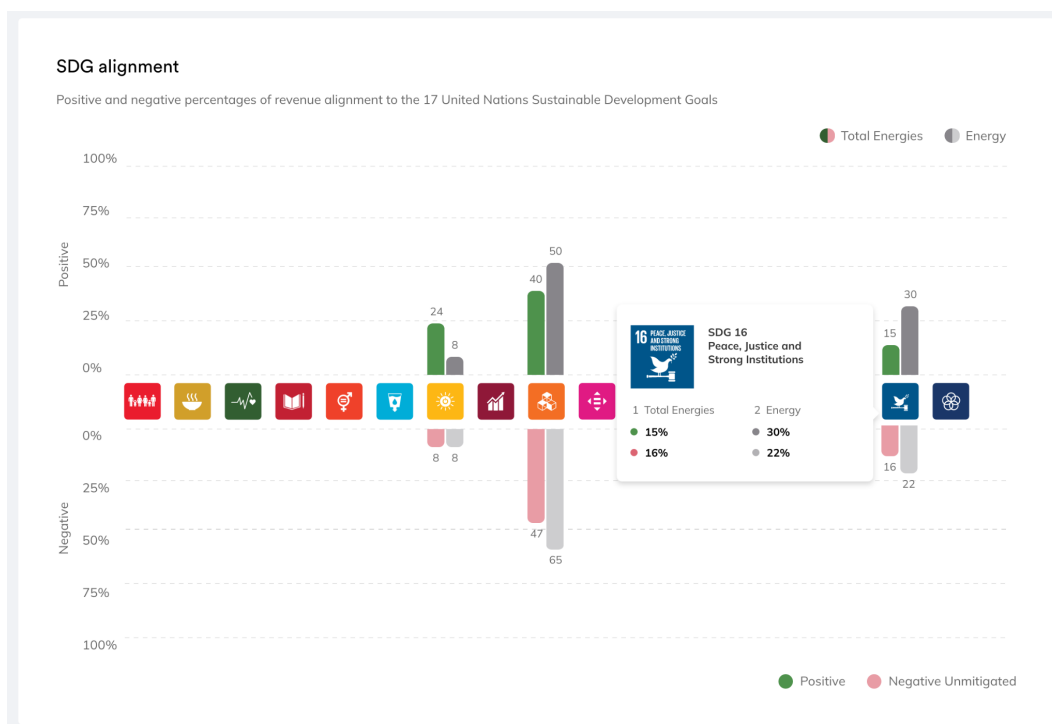
To do so, a materiality assessment is essential. impak uses a dynamic double materiality approach (see the Useful Definitions section below), as recommended in the Update of the Non-Binding Guidelines on the European Union Non-Financial Reporting Directive (NFRD).

Once the negative SDG contributions have been identified through the materiality assessment, the analysis focuses on the mitigation of said negative contributions, meaning the nature of the measures taken by the organization to reduce its negative contributions to the SDGs.

The next step consists of identifying the positive contributions. Here, we rely on the organization's annual reports to provide enough information to allow for a clear understanding of how the activities that are considered "positively aligned" are linked to the outcomes described in the

United Nations' 17 Sustainable Development Goals (SDGs). Consequently, considered positive contributions that cannot be linked to an SDG target are excluded from further analysis.

The result of the iSA analysis can be illustrated by the "SDG alignment," as shown in the image below. The SDG alignment represents the share of revenue linked to each positive and negative contribution. The steps to select the positive and negative contributions and calculate their associated revenue share are further detailed in sections 2.1 and 2.3.



## 2.1 Potential negative SDG contributions

The iSA analysis is based on a **double materiality** approach, meaning that impak identifies the risks that the environment or society poses to an organization, its development, performance, market position and value creation (financial materiality), as well as the impacts that the organization generates on people and the environment (impact materiality).

### Assessing sectorial materiality

In order to conduct a materiality assessment of a specific organization, we analyze the sector to which it belongs—which we call sector-based materiality. Sector-based materiality is defined as SDG-based outcomes that are common to a sector given the sector's intrinsic characteristics such as its production processes and final products or services. For example, the mining industry is often associated with risks related to heavy water consumption and relationships with local communities. In the garment and footwear sectors, risks associated with the respect for trade union rights, occupational health and safety, and low wages are the most common.

This process identifies and prioritizes material outcomes for a company across 173 sectors (based on the Industry Classification Benchmark known as ICB). It assesses the significant impacts of a company throughout its entire value chain with a life-cycle approach. For some organizations, their most important impacts may occur upstream or downstream in their value chain instead of within their own operations. Each material outcome is linked to an SDG and a target.

Sector-based materiality is built on credible data to foster objectivity, robustness, and relevance, encompassing multiple **relevant international norms and standards**<sup>1</sup> and market-driven standards<sup>2</sup>. Notably, initiatives that link the SDGs to private companies' activities such as the Global Reporting Initiative (GRI), the United National Principles for Responsible Investment (UNPRI), the UN Global Compact, the Value Reporting Foundation (the VRF, formerly the Sustainability Accounting Standards Board or SASB), and UNEP FI are used as the basis of the materiality assessment.

To represent the distribution of the negative contributions to SDGs in percentage, impak uses ICB sectors (level 4, with the most granularity) linked to the companies' business lines and their share of revenue.

For example :

A company has two business lines associated with the ICB4 sectors *Gold Mining* (representing 40% of the total revenue) and *Life Insurance* (representing 60% of the total revenue). Its negative contribution to SDG 6, Clean Water & Sanitation only concerns its mining activities, because mining activities are related to the outcome "water pollution" which is associated with SDG 6. Then the contribution of the company to SDG 6 is 40%.

A company has a business line representing 30% of its activities which ICB4 is related to the outcome "water pollution" and another business line representing 40% of its activities which ICB4 is related to the outcome "water withdrawal and consumption". Both outcomes are associated with the same SDG, SDG 6 Clean Water & Sanitation, so the total share of the company's activities associated with SDG 6 is  $30\% + 40\% = 70\%$ .

As explained above, each sector is associated with a materiality including the relevant negative social, environmental and governmental SDG-based outcomes. Therefore, each outcome is connected to a different SDG and one or a few sectors, a distribution that is illustrated in the image above.

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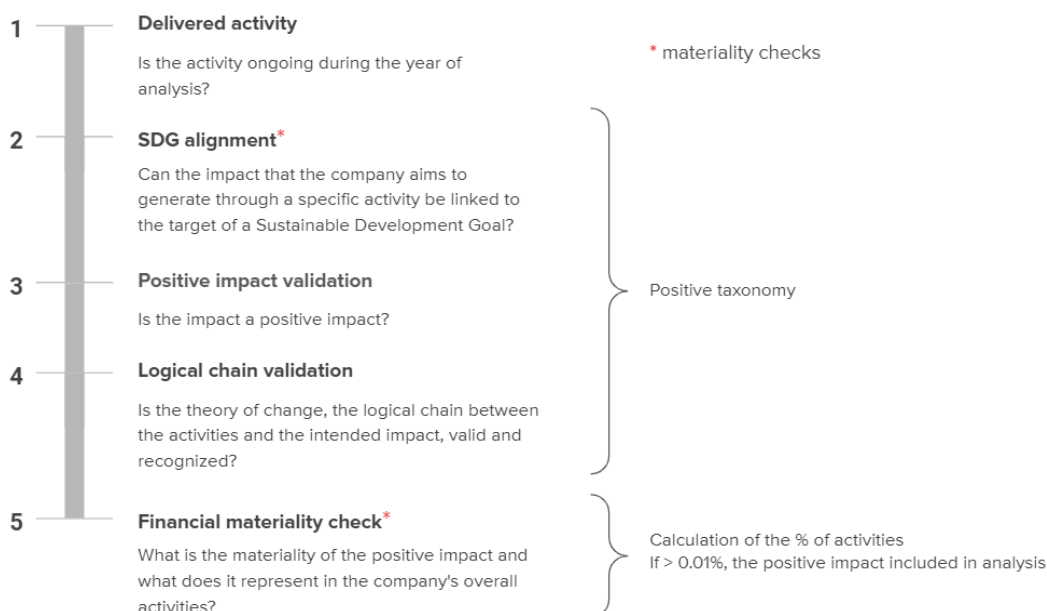
<sup>1</sup> Including, but not limited to the Universal Declaration of Human Rights, the ILO Declaration on Fundamental Principles and Rights at Work, the European Convention on Human Rights, the European Social Charter, the Sustainable Development Goals (SDGs), the UN Guiding Principles on Business and Human Rights, The Ten Principles of the Global Compact of the United Nations, The OECD Guidelines for Multinational Enterprises, the Paris Agreement on Climate Change, the United Nations Framework Convention on Climate Change, the WHO Air Quality Guidelines for Europe.

<sup>2</sup> Including, but not limited to the International Finance Corporation: IFC Performance Standards, the World Benchmarking Alliance Social Transformation, the KnowTheChain benchmarks, Living wage financials, Encore Natural Capital, the Access to Medicine Foundation.

## 2.2 Positive SDG contributions

An organization can have one or more activities that align positively with the SDGs. Linking corporate activity to SDG targets is contingent on an organization's ability to provide sufficient information for analysis. Each SDG target has been transposed into one or more outcomes by our team of expert analysts.

To validate the positive contribution(s) of an organization, the following criteria must all be met by the organization (refer to the *impak Methodology document* section 3.1 for more details):



**Criterion 1: Is the impact, which the organization aims to generate, the result of concrete and ongoing activities?**

When it comes to positive impacts, only the activities actively contributing to the outcome are considered. Planned activities or measures implemented that have yet to produce an outcome will not be considered.

**Criterion 2: Can the activity's goal be linked to an SDG target?**

impak has decided to use the political and global consensus around the SDGs to define whether an activity should constitute a positive impact. Therefore, there must be a clear link between an activity and an existing SDG target to establish an SDG contribution in an iSA, and to conclude a positive impact in a full impact assessment (iS2). In order to qualify an activity as positively aligned with an SDG, it must also respect the conditions included in the target such as the targeted stakeholder.

More generally, if there is no link between the activity and an SDG target, the activity is not considered as a positive contribution to the SDGs.

***Criterion 3: Do the activities meet the threshold between negative impact mitigation and positive impact generation?***

Please note that an observable positive change in the life of a stakeholder does not automatically predicate a positive contribution to the SDGs. The IMP Norms, now hosted by Impact Frontiers, identify the tipping point at which the outcome is considered as having a positive impact on stakeholders (see section 5. Useful Definitions). The threshold distinguishes a positive change generated for the benefit of the organization itself from that of the stakeholders. In the first instance, the activity would still be considered as a mitigation of an organization's negative impact and thus not as having a positive impact.

***Criterion 4: Is the Theory of Change valid and recognized?***

This criterion examines whether the activities of the organization can actually produce the intended effect and generate positive and lasting results in the life of the stakeholder(s). A Theory of Change (ToC) (see Useful Definitions) is considered valid when each of its causal links is evidenced and crystal clear.

Note that it is up to the organization to provide sufficient information to assess, with a reasonable level of certainty, the causal links between the activities and the intended positive outcome. If the link between a given activity and an SDG target is unclear or lacks an expert consensus, then the activity is not considered as generating a positive impact.

***Criterion 5: Is the contribution material, and what does it represent in terms of the company's activities?***



We consider that a positive contribution reaches financial materiality when it represents more than 0.01% of the company's activities. Activities are expressed in revenues, operating expenses or capital expenditures.

If the percentage of activities that have a positive contribution is <0.01%, we do not consider the impact to be material. If there is insufficient data to calculate a representative percentage, the activity is not retained as generating a positive contribution.

**Considered positive SDG contributions**

As one may imagine, some considered activities do not pass one or more of the five criteria above, and have been excluded from the selection of positive contributions. The excluded activities and the justification behind their exclusion can be found in a dedicated section on iSA.

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**Considered positive SDG contributions**

SDG	Activity	Outcome	Criteria	Criteria justification(s)
	- Generating and selling power and heat from biomass	Increase in the use and production of renewable energy in the energy mix	<ul style="list-style-type: none"> <li>✓ Delivered activity</li> <li>✓ Linked to SDG target</li> <li>✓ Validated Theory of Change</li> <li>✓ Reached threshold</li> <li>✗ Reached financial materiality</li> </ul>	Considered as positive impact, but lack of information to calculate % of activities
	-Collaborating with the municipalities in Germany by sponsoring the decommissioned lightship to provide tourists with information about the history and habitat of the Wadden Sea	Promotion of sustainable tourism that creates jobs and promotes local culture and products	<ul style="list-style-type: none"> <li>✓ Delivered activity</li> <li>✓ Linked to SDG target</li> <li>✗ Validated Theory of Change</li> <li>✓ Reached threshold</li> <li>✗ Reached financial materiality</li> </ul>	The organization does not provide sufficient proof the activities can turn into the desired outcome

**Actual positive SDG contributions**

Activities that meet all 5 criteria are called “actual positive SDG contributions”. They constitute the basis of the Potential impact indicator.

**Nota bene:** Retained contributions to SDGs are not *actual positive impacts* as the term is used in impact methodology and cannot be considered as such. Indeed, a positive SDG contribution does not measure the effect of the outcome on stakeholders, for example. The assessment of positive impacts (and negative impacts) is done via the impact statement on iS<sup>2</sup>. iSA solely provides indicators of which material impacts the organization may generate and which SDG targets they may potentially contribute to.

**Actual positive SDG contributions**

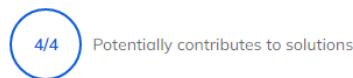
SDG	Activity	Part of activities addressing SGD	Outcome	Stakeholders
	Providing sustainable energy solutions to customers through the manufacturing and installation of wind turbines	100%	Facilitation of the transition from fossil fuel energy to renewable energy	Direct: Local ecosystems Indirect: Citizens Indirect: National governments Direct: Utility companies, power plant/energy developers, and Independent Power Providers (IPP) for community and national, on-grid solutions.



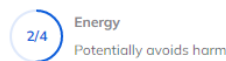
## 2.3 The Potential Impact Indicator

The Potential Impact Indicator is a key part of iSA. As per the picture below, it provides users with an indication of the potential impact of an organization and was built to correlate with the **impak Score™**. The Potential Impact Indicator is a 4-notch indicator. Each notch is categorized from worst to best (1 to 4) as per the picture below: **1. Potentially causes harm; 2. Potentially avoids harm; 3. Potentially benefits stakeholders and 4. Potentially Contributes to solutions.**

### Potential impact indicators



### Benchmarking potential impact indicators



It is calculated using a simple formula based on 2 factors:

- The percentage of activities of the company that has a potential positive contribution to SDGs, and;
- The way with which the company mitigates its negative impacts.

The first step is to associate a **preliminary indicator** based on the company's positive SDG contribution strategy. According to the cumulative percentage of activities (revenues, Opex or assets) potentially contributing positively to SDGs, the company will start in a different bracket:

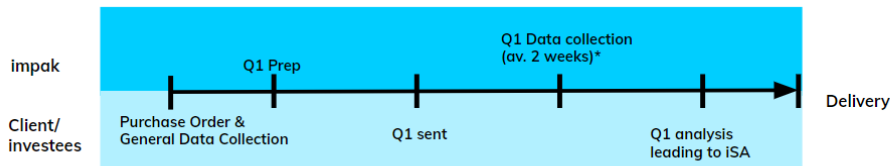
- i. If the percentage of activities is 0% ( $x = 0\%$ ), the company will start as a 1 (potentially causes harm);
- ii. If the percentage of activities is between 0 and 1% ( $0\% < x \leq 1\%$ ), the company will start as a 2 (potentially avoids harm);
- iii. If the percentage of activities is between 1 and 15% ( $1\% < x \leq 15\%$ ), the company will start as a 3 (potentially benefits stakeholders);
- iv. If the percentage of activities is above 15% ( $x > 15\%$ ), the company will start as a 4 (potentially contributes to solutions);

The second and last step is to consider the companies' negative impact mitigation strategy.

- i. If the company starts as a 1 (potentially causes harm):
  - a. and it has put in place mitigation activities for all of its material negative SDG contributions, the company will become a 2 (potentially avoids harm)
  - b. if mitigation activities are missing, the company will remain a 1 (potentially causes harm).
- ii. In all other cases, the company will be downgraded by 1 notch for each unmitigated material negative SDG contribution.

### 3. iSA for private companies

Retrieving information from listed companies and private companies to assess their contribution to the SDGs presents different challenges. On the one hand, listed companies often provide detailed sustainability reports in which their negative and positive impacts and mitigation activities are described. Private companies, on the other hand, very rarely communicate publicly about their impacts and mitigation activities. impak designed two different processes to be able to assess all types of companies.



\* Data collection time largely depends on issuer relationship with Client and is largely out of impak's control; for pre-investment Due Diligence we expect this time to be shorter however

General data collection  
Company name, sector, website

Q1  
-SDG Alignment + materiality questionnaire (output iSA)  
-Adapted to issuer activities & sector  
-Time requirement for issuers: 45-min -1h

To collect data from private companies, impak uses a questionnaire (known as the Q1) sent to the companies, asking them to fill in the following information:

#### A profile section

- Comprises of 3 questions on general company information

#### A partially pre-filled negative outcomes section

Our experts identified four questions for each negative SDG contribution. Note that a maximum of 20 material negative SDG contributions can be identified.

In the Negative SDG contribution section, the organization must describe the activities that contribute to each outcome. The Negative SDG contribution section is pre-filled by impak's analysts based on sector materiality, but it is always possible for the organization to add more information in the dedicated fields. impak encourages organizations to be as precise as possible, since validating a contribution requires a lot of information. impak focuses on the activities' impact on the organization's value chain, and how they mitigate it.

If the organization disagrees or identifies gaps between the assessment and reality, it should provide evidence as to why such potential negative SDG contribution does not apply to its specific situation. Insufficient evidence or a lack thereof will result in the initial materiality assessment being used as is.

#### Mitigation activities

This question focuses on mitigation activities and goes as follows: What measures does your organization have in place to reduce the identified negative SDG contribution?

*Examples of answers:*

- The organization improved its procedures through the X process. The organization now uses X technology.
- The organization implemented supplier audits.

Nota bene: Mitigation activities must be concrete and measurable actions (qualitatively or quantitatively), and implemented by the company alone or in a partnership *during the year of analysis*, but not by a partner alone.

### **Stakeholders**

The definition of stakeholders (see section 5. Useful Definitions) in impact management is slightly different from the common definition. Furthermore, note that one activity can generate more than one outcome; hence it can impact multiple stakeholders.

SDG targets—where each outcome is linked to one target— often specify to which stakeholders they can be applied.

*Example of multiple stakeholders related to a certain activity:*

- An organization produces masks for lumberjacks. Any malfunction of said masks would negatively contribute to the outcome of “Consumer’s welfare, health and safety” since it would affect the lumberjacks’ health and safety. Other outcomes related to the production of masks can include “Water pollution”, “Energy consumption”, “Biodiversity and ecosystem degradation”, and “Supply chain management”, because the production requires inputs such as water and energy, as well as materials such as rubber. Each of these inputs raises concerns relative to the mentioned outcomes. Each of these outcomes has its own stakeholders: local ecosystems, local communities, and suppliers, among others.

### **Positive outcomes**

The positive outcomes section comprises approximately five questions for each positive outcome. Only the five most significant positive outcomes will be identified and assessed for contribution.

As seen previously, an organization can have one or more activities with a positive SDG contribution to the SDGs (resulting in multiple SDG contributions). It is incumbent on the organization to provide sufficient information for analysts to link its activities to the SDG targets. To be able to validate the positive contribution(s) of an organization, the above-mentioned validation criteria must all be met (see section 2.2).

Note that it is up to the organization to provide sufficient information to assess, with a reasonable level of certainty, the causal links between the activities and the intended positive outcome. If the link between a given activity and an SDG target is unclear or lacks expert consensus, then the activity is not considered to generate a positive contribution.

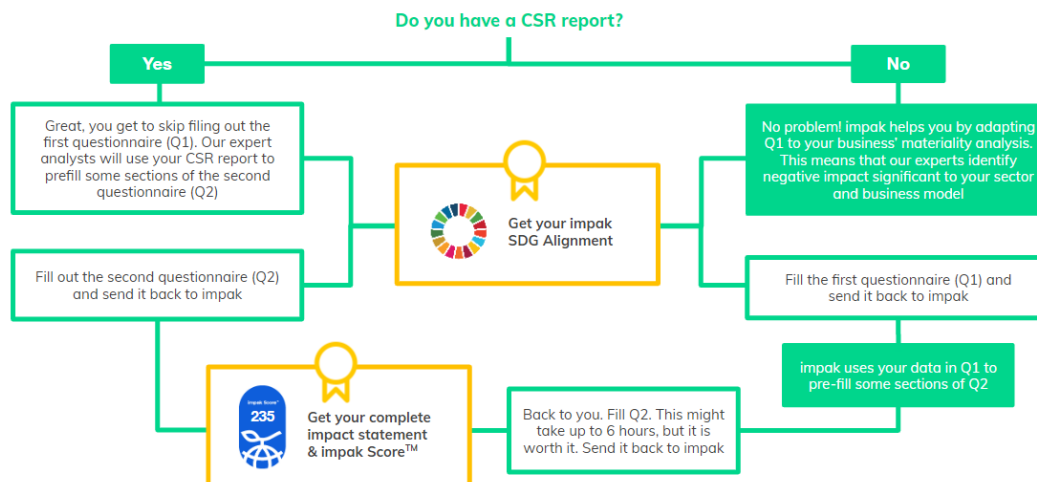
### **Potential Eligibility to the European Taxonomy (upon request)**

The last data point in an iSA focuses on the potential eligibility of the organization for the EU Taxonomy (see section 5. Useful Definitions) based on the organization’s sector. The organization must identify whether its activities contribute to one or more of the EU Taxonomy activities in the Q1 and the share of revenue it derives from these activities.

Once the data is collected from the company impak analysts may follow up for additional information to confirm potential alignments or other topics. Afterwards, data is filed in the database, a summary is produced, and a potential impact indicator is automatically generated.

## 4. Conclusion

To conclude, the iSA analysis offers an introductory assessment of the potential impacts of a company. It provides the basis for a complete IS2 analysis (see the image below).



It can also be combined with additional modules (SFDR, Climate strategy).

A stand-alone iSA can be useful to:

- Qualify the potential impacts of an investment universe
- Help build portfolios, identify companies regarding their links to specific SDGs, etc.
- Benchmark portfolio companies' potential positive and negative impacts performance to a reference index

## 5. Useful definitions

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**Double materiality:** The double materiality perspective allows for the identification of the risks that the environment or society poses to an organization, its development, financial performance and position, value creation (financial materiality), AND the impacts that the organization has on the economy, the environment and people (impact materiality). iSA covers the significant SDG contributions of an organization throughout its entire value chain, and through a life-cycle approach.

*Example of a double materiality perspective:* Regarding climate change, on the one hand, an organization will want to understand how physical and transition risks may impact its value as weather events may harm the organization's manufacturing sites. On the other hand, the organization emits GHG emissions that impact the environment and people's livelihoods.

**EU Taxonomy:** The EU Taxonomy is a regulatory classification system aimed at investors, companies, and other participants of the financial market to define which economic activities can be considered environmentally sustainable, and under which conditions.

**Impact:** An impact is a change in the life of stakeholders lasting in time.

**Materiality assessment:** The materiality assessment is the analysis of the organization's sector, the characteristics of its activities and business model as well as the organization's context (geographical locations, size, nature of its activities and products, sourcing model, etc.)

**Potential negative SDG contribution:** A potential negative contribution is when the organization could potentially induce negative change according to the priorities set by the SDGs.

Attention: Adding a new filter to machinery that produces NOx, reusing water in the manufacturing process, implementing safety training for employees at higher risk of injuries or any initiative aiming to reduce a negative impact is considered a mitigation measure. However, these types of initiatives do not qualify as positive contributions.

**Considered positive SDG contribution:** A considered positive contribution is when the organization could induce positive change according to the priorities set by the SDGs

**Stakeholder:** Stakeholders are entities that are exposed to the effects of the outcome. They can be individuals, legal entities or environmental systems, such as vulnerable species or local ecosystems.

**Sustainable Development Goals (SDGs):** The goals are identified by the United Nations as the 17 most urgent issues the world is facing, each with associated targets for 2030. Each negative and positive impact is linked to one of the 169 targets.

**Theory of Change:** The Theory of Change (ToC) is the logical chain between the activities and the intended result. It is sometimes referred to as "Impact Chain", and is a specific type of planning, participation, and evaluation methodology that is used in business to promote change. It explains the process of change by describing the causal links of an initiative, i.e. its short-, medium-, and long-term outcomes and, most importantly, how outputs (activities) turn into outcomes (results of the activities).

**Threshold:** The threshold examines the gap between the mitigation of negative impacts and the generation of positive impacts. It is at the heart of the theory of impact.

*Example of threshold:* An organization produces renewable energy through wind turbines. The organization can a) generate this renewable energy for others - and help increase the share of renewable energy in the global energy mix. This is the definition of positive impact generation. The organization can also b) generate this renewable energy for its own energy consumption. In this case, the renewable energy activity will therefore be only considered as potentially mitigating a negative impact, which is energy consumption.



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