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Research paper

Materiality assessment: contribution to single or double materiality debate

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The views expressed are those of the authors alone.

Executive Summary and recommendations

ES 1 This paper analyses current materiality definitions and materiality determination processes. Following a careful analysis of materiality definitions and materiality determination processes we make the following recommendations taking in mind that "the materiality concept could be often linked to relevance as stated in the European directive or by IIRC and CDSB in a sense that a material information is generally considered to be a relevant information".

ES 2 The revised NFRD (Non-Financial Reporting Directive) aimed to clarify that non-financial information is intended to provide useful information to a broad spectrum of users (and not only financial users). Such a spectrum includes shareholders and creditors, employees, suppliers and business partners, existing and potential customers, tax and other public authorities and society in general (NGOS (Non-governmental Organisations) and citizens). In order to avoid discrepancies between management information and disclosures to stakeholders, non-financial information as disclosed should at one and the same time (i) be aligned with the information used internally by decision-makers while (ii) be mindful of reasonable business confidentiality limits.

ES3 Currently, though the NFRD refers to the double materiality concept, diverse interpretations exist, and it has created a hard line between two groups: some interpreted materiality to be the addition of both dimensions while others considered materiality to be the intersection of the two. Furthermore, the current concept set-up in the Accounting Directive is primarily linked to the financial usefulness expected by a shareholder or an investor. Therefore, we recommend to carefully reconsider the definition to avoid confusion. For example, the Corporate Reporting Dialogue (CRD) has already proposed a revised definition which goes beyond strict financial aspects: "Material information is any information which is reasonably capable of making a difference to the conclusions stakeholders may draw when reviewing the related information". This could be an interesting starting point. As a consequence, there is a need to strike a reasonable balance between expectations of various stakeholder groups and this is the responsibility of a standard-setting process on the basis of agreed-upon criteria.

ES4 Over and above stakeholders' expectations, materiality may also be considered according to time horizons: for example, the IIRC's (International Integrated Reporting Council) suggestion to consider short, medium- and long-term potential impacts affecting the entity's ability to create value could be a welcome addition to the definition of materiality.

ES5 The following addition from the IIRC in the CRD materiality report is also interesting: it suggests to consider "the sustainability of the financial, social, economic and environmental systems within which it operates; the various opportunities and risks to which it is exposed, as well as on the quality of its relationships with, and assessments by, its stakeholders". It would link

materiality with risk management. It would also help recognise that the foundation of materiality (and potential risk to the entity's value creation process) is the sustainability of the environmental & social systems upon which an organisation relies.

ES6 Finally, materiality will need to be explicitly linked to external social and ecological thresholds (planetary boundaries and social foundations, see Kate Raworth's work and the Stockholm Resilience's centre's work) in a context-based approach.

ES7 We also recommend thinking about including references to the value creation process, which is inclusive of risks, financial materiality and importance of matters (see the approach taken in the Social and Human Capital Protocol, 2019), and the definition of salient human rights (Shift, Mazars, 2017).

ES8 We recommend disclosure of the materiality assessment process to help better understand the impact on/of business and the priority issues identified by the management.

ES9 Key recommendations based on the WBCSD Reporting matters 2019, Deloitte 2018 report, and the IIRC background papers are:

1. Have a written methodology to identify, prioritize and validate material issues.

2. Materiality should be reassessed every 2 or 3 years maximum.

3. Describe specific steps taken to identify material issues:

- including how you took the perspective of the key stakeholders into account, and how you selected them
- including how you took the perspective of your organisation into account
- including how you took the foundational elements from scientific sources that validate industry specific priorities.
- including how you took the perspective of national priorities/legal background elements (e.g. Duty of Vigilance Law, SDG priorities)
- identifying sustainability thresholds and social foundations related to your organisation

4. Assess the importance of identified matters: magnitude and likelihood of impacts

5. Prioritize using elements such as external trends, align materiality process with enterprise risk management; prioritize using the time factor (long term matters should be not be overlooked).

6. Disclose a prioritized list of outcomes through a matrix or concise list of highly material issues. Disclose short, medium- and long-term material elements, and both positive and negative matters.

Acknowledge the connectivity of materiality topics and how they can overlap each other. Where appropriate, acknowledge divisional and geographical differences;

7. Align the content of your report with outcomes of the materiality assessment, including strategy, targets, performance indicators, evidence of activities and details on implementation and control mechanisms;

8. Demonstrate internal validation of the results of the materiality assessment (e.g. board governance level);

9. And explain how third parties contributed to the assessment process or validation of outcomes (audit).

ES 10 We believe that a set of mandatory core material topics for all companies would be a useful first step for European non-financial standards. In addition, a minimum set of materiality topics per sector on “a comply or explain” basis would be necessary.

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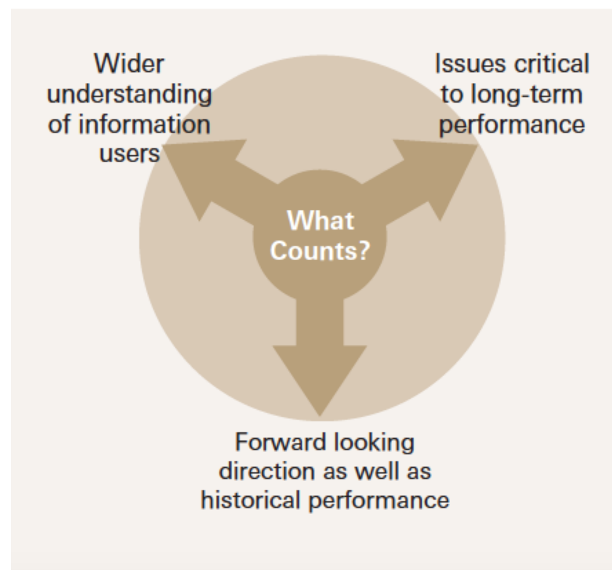
1. Introduction

1.1 According to Puroila and Mäkelä (2019), the process of identifying and prioritising material information on corporate sustainability performance is of great importance. ***Indeed, it provides "legitimate closure" to the reporting content, as well as to how the corporation understands sustainability. Therefore, the concept of materiality has broader societal impact.***

1.2 The former definition of what is material was: "Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements" (IASB, 2010). In 2018, the definition of what is "material" in financial statements was clarified by the IASB as "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."

1.3 With sustainability becoming key for business actors, materiality has widened its focus: "New approaches to determining what information is material need to be able to address stakeholders' requirements for both forward and backward looking perspectives, narrative reporting and comparable data with a level of accuracy and detail sufficient to inform decision making" (Accountability, 2006, p. 15).



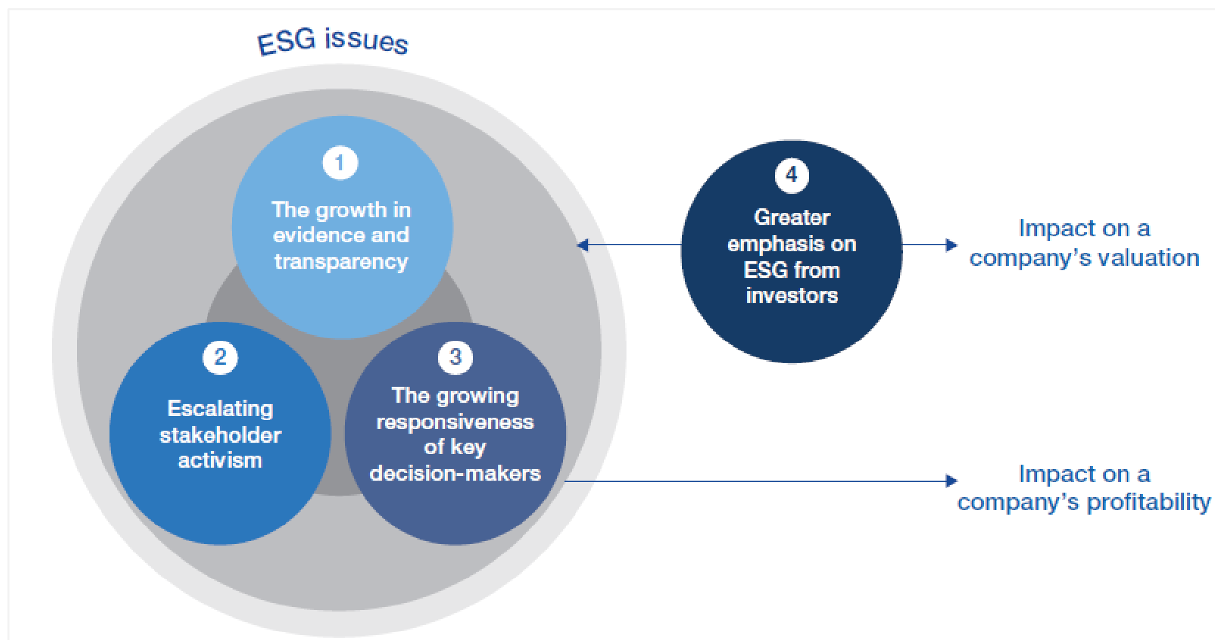
Accountability (2006, p. 14)

1.4 The state of play of materiality practice in sustainability disclosure today demonstrates that this concept is widely implemented: 80% of the world's largest 250 companies (KPMG, 2014), and more recently, a Datamaran study (2019) shows that there has been an increase in the number

of companies with a market capital above $ 20 billion doing the assessment, from just 69 companies reporting on materiality in 2011 to 329 in 2018.

1.5 Despite the now widespread use of materiality in sustainability disclosure, there is no common definition of materiality, no common process to determine materiality, and therefore quality of this process varies widely. This leads to potential greenwashing use (avoidance of certain material issues), wrong decision-making (materiality led by "fashionable sustainability issues"), and therefore to wrong information being published to stakeholders.

1.6. Especially materiality analysis can be considered as a dynamic process: In its report entitled "Embracing the New Age of Materiality - Harnessing the Pace of Change in ESG", the World Economic Forum highlighted this reporting "pressure", particularly due to the "era of hyper-transparency" in which companies are evolving, leading to increased demands on companies for ESG data. In this regard, BlackRock President and CEO Larry Fink's January 2020 annual letter to CEOs is evocative[1]: "We believe that all investors, along with regulators, insurers, and the public, need a clearer picture of how companies are managing sustainability-related issues. This data should extend beyond climate to questions around how each company serves its full set of stakeholders, such as the diversity of its workforce, the sustainability of its supply chain, or how well it protects its customers' data. Each company's prospects for growth are inextricable from its ability to operate sustainably and serve its full set of stakeholders.



1.7 In particular, the resulting report of the World Economic Forum noted a crucial challenge in terms of materiality analysis - pointing out that **the rate at which issues that are now considered**

[1] See https://www.blackrock.com/us/individual/larry-fink-ceo-letter

non-material are becoming material for enterprises is accelerating[2]. The combination of increased transparency requirements and the growing influence of corporate stakeholders is one of the reasons for this acceleration. Stakeholders, particularly NGOs and civil society, are now much better equipped to have an impact on a company's performance, often before most investors are aware of it. Moreover, these stakeholders - in addition to the consequences associated with climate change and its socio-economic impacts in particular - will require the company to consider its environmental and social impact, beyond the potential effects of the latter on its business model. **Therefore, the ability of companies to anticipate stakeholder reactions to emerging sustainability issues and how they might affect a company and its performance is essential.**

In this sense, the study by Rogers and Serafeim (2019)[3] is particularly evocative: the authors attempt to develop a *framework* explaining how ESG issues become financially 'material', arguing that materiality is not a *state* of *being* but a process *of becoming*. The framework aims firstly to support companies and investors in making resource allocation decisions based on expectations about future materiality - but also civil society and NGOs in developing theories of social change, and policy makers in designing reporting regulations.

	Status Quo	Catalyst	Stakeholder Pressure	Company Response	Regulatory Response and Innovation
	Issue financially immaterial	**Issue still financially immaterial**	**Issue becoming financially material for some companies**	**First sign issue could become financially material for entire industry**	**Issue financially material for entire industry**
Description of state	Degree of misalignment between business and societal interests is tolerated and no industry players pursue increased profits by increasing negative externalities. Misalignment is either accepted by societal norms or due to a lack of information about true state of affairs.	Some companies deviate from equilibrium seeking to capture more rents, increasing business and social misalignment. Some companies are successful in capturing rents. Alternatively, societal expectations can change due to information about companies' existing behavior and about true state of negative externalities.	NGOs, media and other stakeholders react to the furthering of the misalignment between business and societal interests. Political stirring may occur, but action is unlikely at this point. Public ire is generally focused on the offending companies and not on the practices of the industry as a whole.	Companies attempt to regain trust through company-specific or industry self-regulation, aiming to minimize the cost of reaction while successfully deterring stakeholder pressure and regulation. Politicians or regulators threaten action in response to misalignment. New norms and beliefs are set for industry behavior.	New regulation forces firms to decrease misalignment, creating a new equilibrium. Alternatively, innovation disruptions the industry leading to a new equilibrium. Either through regulation or innovation, the issue is integrated into the competitive landscape of the industry.
Hypothesis	Issues are more likely to become financially material in industries and countries with weaker norms and beliefs that societal and business interests should be aligned.	Issues are more likely to become financially material when it is easier for stakeholders to receive information about the true alignment between societal and business interests.	Issues are more likely to become financially material when media and NGOs have more power and when politicians are more responsive to this power. Issues will remain material for one (or several) companies if performance on the issue can be isolated from the rest of the industry or if it deviates significantly from industry norms.	Issues are more likely to become financially material when companies lack ability to self-regulate and truly address the issues of misalignment.	Issues more likely to become financially material when new regulations are enforced or when some companies develop an innovation that addresses the misalignment offering a differentiated service/product.
Misalignment	Misalignment is minimal or within a margin accepted by society. Moreover, misalignment is static.	Misalignment is increasing, either due to corporate actions or changing societal expectations.	Misalignment peaks. Diverging companies cease further misalignment increases and see if the negative public response continues or gains regulator attention.	Misalignment shrinks as companies, to a degree, walk back actions which drove misalignment. Degree of misalignment is still greater than what would exist in the presence of new regulation or disruptive innovation.	Regulation or disruptive innovation drives misalignment to a new equilibrium level. Misalignment again becomes static.

[2] [illegible] in the face of current and future material ESG challenges. The development of such strategic processes signals a growing recognition of the contribution of sustainability issues to business performance. According to the World Economic Forum, the next step in this evolution will be the introduction of initiatives to improve performance on ESG issues that may be material to the company in the future.

[3] ROGERS J., SERAFEIM G, *Pathways to Materiality*: *How Sustainability Issues Become Financially Material to Corporations and their Investors*, Harvard Business School, Working Paper 20-056.

2. Current definitions

Materiality in a financial context

2.1 "a substantial likelihood that the disclosure of the **omitted fact** would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." U.S. Supreme Court (1976)

2.2 "Information is material if **omitting it or misstating** it could influence decisions that users make **on the basis of financial information** of a specific reporting entity." FASB (2010)

2.3 "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" IASB (2018).

For more insights related to financial definition of materiality, see Annex 1

Materiality definitions for a wide range of stakeholders, from major standardization initiatives

2.4 "'Material Aspects' are those that reflect the organisation's **significant economic, environmental and social impacts**; or that substantively influence the assessments and decisions of **stakeholders**" GRI (2016).

2.5 "An organisation should review all the core subjects to identify which issues are relevant. The identification of relevant issues should be followed **by an assessment of the significance of the organisation's impacts**. The significance of an impact should be considered with reference both **to the stakeholders** concerned and **to the way in which the impact affects sustainable development**." ISO 26000. In the comments part of the CRD (Corporate Reporting Dialogue) document published in 2016, there is a significant additional information given:" Therefore, materiality/ significance needs to be very broadly evaluated, as stakeholder group is diverse and **the reporting obligation appears to include/ extend to non-controlled organisations or activities the reporting entity can influence"**

Materiality definitions with a financial stakeholder primacy, from major standardization initiatives

2.6 "Environmental information is material if: (1) The environmental impacts or results it describes are, due to their size and nature, **expected to have a significant positive or negative effect on the organisation's current, past or future financial condition and operational results and its ability to execute its strategy**; or (2) Omitting, misstating or misinterpreting it could influence decisions that **users of mainstream reports** make about the organisation." CDSB.

2.7 “A matter is material if it could substantively affect **the organisation’s ability to create value in the short, medium or long term**” IIRC. In the comments part of the CRD (Corporate Reporting Dialogue) document published in 2016, there is a significant additional information given “The materiality determination process applies to both **positive and negative matters**, including risks and opportunities and favourable and unfavourable performance or prospects. It also applies to both financial and other information”. The IIRC (2013a) also stated that “An organisation’s ability to create value over time depends on many factors, including the organisation’s strategy; the resilience of its business model; **the sustainability of the financial, social, economic and environmental systems within which it operates**; the various opportunities and risks to which it is exposed, as well as on **the quality of its relationships with, and assessments by, its stakeholders**”.

2.8 “A fact is material if there is a substantial likelihood that the disclosure of the **omitted fact** would be viewed by the **reasonable investor** as having significantly altered the total mix of information...” SASB. In the comments part of the CRD (Corporate Reporting Dialogue) document published in 2016, there is a significant additional information given: “risks, uncertainties, known trends, etc. and implications for both **near and longer-term** entity sustainability”.

2.9 “The Task Force determined that preparers of climate-related financial disclosures should provide such disclosures in their mainstream (i.e., public) annual financial filings”. TCFD (2017); CDSB (2018).

Salient human right issues

2.10 “Something that is salient is prominent or important. It stands out conspicuously. A company’s salient human rights issues are those human rights that stand out because they are at risk of the most severe negative impact through the company’s activities or business relationships. This concept of salience uses **the lens of risk to people**, not the business, as the starting point, while recognizing that where risks to people’s human rights are greatest, there is strong convergence with risk to the business.” (Shift, Mazars, 2017).

2.11 The WBCSD explains the differences between Salience and Materiality, and how they can converge:

- “Setting the baseline: “salient” and “material” human rights issues. Most international human rights frameworks created after the UN Guiding Principles on Business and Human Rights in 2011 emphasize the identification and reporting by businesses of their “salient” human rights issues. Salient human rights issues refer to those human rights that are at risk of the most severe negative impact through a company’s operations and business relationships.2 Hence, **the concept of saliency focuses on risk to people** as the starting point for businesses’ human rights due diligence.

- Sustainability reporting frameworks generally apply the concept of "materiality," **focusing on risk-to-business**. Material human rights issues are those that are identified based on their impact on business and stakeholders. Materiality focuses on risk-to- business whereas saliency focuses on risk to the people impacted by business. Therefore, sustainability reports typically do not include substantial detail on human rights. Despite this difference, saliency and materiality are not mutually exclusive. In fact, salient human rights issues correlate with risk-to-business and can be part of the process of determining a company's material topics." (WBCSD, 2018)

Current EU non-financial disclosure materiality definition

2.12 The current definition of "materiality" within the accounting directive of the EU is "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."

2.13 The 2014 NFRD did not refer explicitly to a definition of materiality, but the GRI (2017) cites article 1 of the directive as a reference to the materiality concept: Companies are encouraged to report on a wide range of potential issues but they need to assess which information is material, disclosing '[…] information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity […]' (Article 1 of the Directive).

2.14 In 2019, the definition was updated to: "a company is required to disclose information on environmental, social and employee matters, respect for human rights, and bribery and corruption, to the extent that such information is necessary for an understanding of the company's development, performance, position and impact of its activities." (EU, 2019)

The EU "consultation document on the update of the non-binding guidelines on non-financial reporting" document also specifies the "double materiality" concept:

- The reference to the company's "development, performance [and] position" indicates financial materiality. Climate-related information should be reported if it is necessary for an understanding of the development, performance and position of the company. This perspective is typically of most interest to investors.

- The reference to "impact of [the company's] activities" indicates environmental and social materiality. Climate-related information should be reported if it is necessary for an understanding of the external impacts of the company. This perspective is typically of most interest to citizens, consumers, employees, communities and civil society organisations. However, an increasing number of investors also need to know about the climate impacts of investee companies in order to better understand and measure the climate impacts of their investment portfolios.

3. Analysis of Definitions

Purposes of materiality: reporting

3.1 “The application of materiality depends on judgement and is crucial to prioritizing relevant ESG **information for external disclosure**.” WBCSD (2019)

3.2 “The application of materiality ensures that important information **is not obscured,** and that information satisfies reporting requirements, the needs of the intended audience and management’s reporting objectives.” WBCSD (2019)

3.3 “you should view a materiality assessment **as a systematic approach to prioritizing issues** and not a process necessary to meet corporate reporting legal disclosure requirements or expectations.” Social and Human Capital Protocol (2019)

3.4 “Integrate non-financial issues into reporting to present a **more complete picture** to stakeholders.” Datamaran (2019)

3.5 “Materiality plays a crucial role in determining the matters to be included in an integrated report and ensuring conciseness of the report”. Puroila and Mäkelä (2019); IIRC (2013)

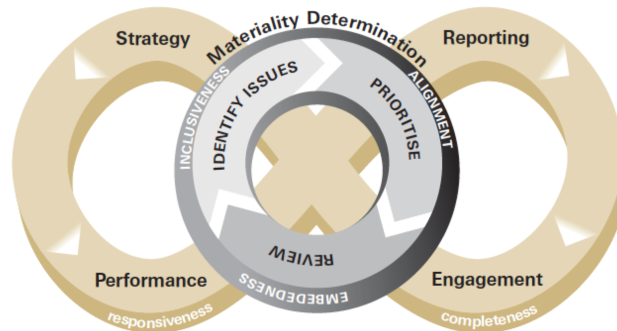
Purpose of materiality: Strategic use

3.6 “how to take materiality beyond reporting, leveraging its informational value **to define strategy, identify and manage risks, as well as seize opportunities**:

- Make better decisions about investment in sustainability (know what is material and where you can have the biggest impact or mitigate the biggest risk).
- Enhance business strategy by using materiality assessment input to reflect new business risks and opportunities.
- Strengthen the foundation of sustainability work by embedding these issues across departments and supply chain.
- Enhance stakeholder engagement by presenting them with viewpoints on issues that illustrate long-term value.
- Stay ahead of continuously evolving stakeholder and regulatory compliance on these issues.” Datamaran (2019)

3.7 “materiality assessment should be used as **a strategic business tool**, with implications beyond corporate responsibility or sustainability reporting. Organisations can get most benefit from their materiality process by using it as an opportunity to apply a sustainability lens to **business risk, opportunity, trend-spotting and enterprise risk management processes.”** (KPMG, 2014, p.3 – see also complete list of reasons)

3.8 Accountability (2006) summarizes and combines both purposes of materiality in this visual (p.5):



The guidance given about the criteria and thresholds for prioritising those issues

3.9 There are several criteria used to define thresholds for prioritization: importance, relevance, significance. Importance would refer to stakeholder choice, relevance would be in consideration with, for example, a value chain's activities, and significance would put topics in relativity with each other.

3.10 "The concept of materiality is intended to increase transparency and accountability by making the reports more focussed on "**what matters**" and reducing the amount of unnecessary sustainability information (GRI, 2016; IIRC, 2013b; Accountability, 2013)." Puroila and Mäkelä (2019)

3.11 "**Relevance**: which social and human capital issues are relevant when considering the activities that occur across a business's value chain (see Step 1)" Social and Human Capital Protocol (2019)

3.12 Significance: **the relative importance** of these issues to a business and their stakeholders (see Steps 1 and 2)." Social and Human Capital Protocol (2019)

Prioritisation criteria

3.13 There are three prioritization criteria: financial impact, sustainability impact, and impact on value creation.

3.14 The first criterion is financial impact of selected issues: According to the Materiality Map from SASB, materiality relies heavily on two types of evidence: "evidence of investor interest" (financial risks, legal drivers, industry norms, stakeholder concerns, innovation opportunity) and "**evidence of financial impact**" (revenues and costs, assets and liabilities, risk profile: cost of capital). SASB, in Puroila and Mäkelä (2019). Finally, the Social and Human Capital Protocol

(2019) cites the influence of issues on the cost of capital, or access to capital, investor interest or insurance conditions as a way to select material issues.

3.15 The next criterion is "sustainability". According to "thresholds that refer not to financial accounting metrics but to the condition of ecology and society within which the business operates. It has for example been argued that sustainability requires contextualization within thresholds. The type of thresholds referred to are often environmental ones, employing concepts such as "critical loads", "tipping points", "ecological carrying capacity" or the nine "Planetary Boundaries" as defined recently by Swedish scientists (www.stockholmresilience.org)". Materiality Tracker Website, 2019 (see also the Social Foundations by Kate Raworth, in her Doughnut Economics book). That means that material topics are related to planetary boundaries for example, and more specifically if your organisation has an impact on those that are already in a dire situation (e.g. climate change).

3.16 The last criterion is prioritization according to "issues that substantively affect **your business's ability to create and destroy value** – for the business and for key stakeholders – over the short, medium and long term. These will be issues that are crucial to decision-making." (Social and Human Capital Protocol, 2019)

Inclusion Criteria

3.17 Material topics could include affecting both internal and external items:

- "**Internal (within the organisation)** – Effect on continuity of operations, licence to operate, profitability, going concern (e.g., effect of customer boycott of products on ethical grounds).
- **External (outside the organisation)** – Effect on external stakeholders and how this reverts back to pressure back on the organisation through enhanced or diminished organisational reputation (e.g., an oil spill in the ocean), or the availability, affordability and quality of capitals upon which the organisation relies (e.g., the availability of clean water)." IIRC (2013a)

According to KPMG (2014), more advanced organisations should**:** "Manage impacts beyond operational control: In order to meet the GRI G4 guidelines, all reporters must disclose the 'boundary'- where the most significant impact of each material topic occurs (inside or outside the organisation). **We would expect more advanced organisations to have a detailed strategy for improving impacts beyond the company's own operatio**ns e.g. for improving environmental impacts of products downstream".

3.18 Material topics should include short, medium- and long-term effects:

- "Short – Direct effect is immediate (e.g., mining safety incident results in penalties and suspension of operations pending investigation, or quality issues that result in an immediate recall with rectification costs).
- Medium – Effect will manifest in a three to five-year time span (e.g., impending water shortages threaten the production process in the future, safety track records affect ability to secure new mining rights and licenses, inability to maintain quality and innovation results in customer loyalty demise).

- Long – Effect will reflect in the ability of the business to create value in the long term, typically defined as greater than five years into the future (e.g., fossil fuel technology businesses invest meaningfully in renewable energy solutions and demonstrate commitment to and progress against plans)" IIRC (2013a)

3.19 Material items should both include "**positive and negative matters** (e.g., opportunities and risks, favourable and unfavourable results or prospects for the future)" (IIRC, 2013a).

This is also emphasized in the principled materialization process that the UN Global Compact introduced for SDG reporting in 2018, with two entry points "risks" and "beneficial products, services or investments" (UN Global Compact, 2018, p. 11):

Step 1.2: Conduct principled prioritization of SDG targets

☑ As explained in the introduction, principled prioritization is a process to identify the priority SDG targets for a company to focus on to contribute to achieving the SDGs. Below are the two entry points through which a company can identify priority SDG targets by assessing the significant impacts linked to its operations and value chain.

☑ Entry point A: Assess how priority risks to people and the environment relate to SDG targets.

- The focus here is on identifying the most severe negative impacts on people and the environment that are linked to the company's operations and value chain and the SDG targets to which these impacts relate. These impacts include the 'salient' human rights risks or issues (see Box 4).
- The objective is to identify opportunities to tackle these risks in ways that maximize positive outcomes for people and the environment and therefore for the SDGs.

☑ Entry point B: Identify SDG targets you can best contribute to through beneficial products, services or investments.

- The focus here is on how the company can apply its skills and capabilities to develop products, services or investments that contribute to the achievement of the SDGs. While this might not be immediately possible for some companies, the exercise could highlight ideas to make this possible in the future.
- The objective is to ensure that these beneficial products, services or investments are also developed and delivered in ways that minimize any negative impacts and therefore reinforce the viability of the company in the long term.

3.20 Material items should be connected and included in a systemic view (KPMG, 2014, Datamaran, 2018).

Minimum list of material topics

3.21 The IIRC and sustainability specialist Elaine Cohen advocates for a minimum set of materiality topics per sector:

"There should be a harmonized standard baseline of disclosures that are relevant to all companies - some will be more critical than others for different companies - but they are relevant - and material - for all. I call this Operational Materiality.

Then we should have materiality that is precise enough to differentiate - focusing on the specific aspects of a company's impacts that are a directly relevant to its business, the locations it operates in and the influence it has on society. Let's call that Precision Materiality." (Elaine Cohen, 2017)

The IIRC (2013) also points towards that direction:

"**Comparing matters identified with those being reported on by organisations in the same or similar industries** may help to ensure that relevant matters have not been excluded from the population of relevant matters for <IR> purposes. Matters should not be excluded on the basis that an organisation does not wish to address them or does not know how to deal with them."

4. Materiality and its link with risk management

4.1 According to the WBCSD Sustainability and Enterprise Risk Management report (2016), "Less than one in three issues identified in sustainability materiality assessments are disclosed as risk factors in legal filings for investors". As a result, in the same report it is recommended that "Using the results of a materiality assessment as an input into the risk identification process".

4.2 On the other side, materiality is dynamic and should also be influenced by changes in risk and understanding of risk: "Materiality is a **dynamic concept**, and the materiality of ESG issues evolves over time. This evolution is driven by changes in legislation and policy, by changes in risk and the understanding of risk, by changes in the social, environmental and economic impacts of the ESG issue in question, and by changes in societal (and beneficiary) expectations and norms." UNGC, PRI (2015)

4.3 Finally, materiality and risk management are interrelated through the fact that materiality also considers financial risks and, evidence of financial impact, at least in the materiality definitions that SASB and TCFD use. SASB says "The Materiality Map relies heavily on two types of evidence: "evidence of investor interest" (**financial risks**, legal drivers, industry norms, stakeholder concerns, innovation opportunity) and "evidence of financial impact" (revenues and costs, assets and liabilities, risk profile: cost of capital)" and "**A forward-looking adjustment** (probability and magnitude, externalities) acknowledges emerging issues, which are not yet reflected in the evidence-based tests" SASB, in Puroila and Mäkelä, (2019)

4.4 In the Social and Human Capital Protocol approach to materiality, the list of items are also very similar to risks categories:

- Operational: the extent to which the social and human capital impact or dependency may significantly affect business operations, project implementation or the value of existing or new product(s).
- Legal and regulatory: the extent to which the social and human capital impact or dependency may trigger a legal process or liability.
- Reputational and marketing: the extent to which the social and human capital impact or dependency may affect the product portfolio, company image or relationship with customers and other stakeholders (e.g., changing customer preferences)". (Social and Human Capital Protocol, 2019)

5. Critiques and limits of materiality

5.1 Materiality is critiqued for providing a unitary view that denies any conflict between different stakeholders (Puroila and Mäkelä, 2019). It is also often critiqued for portraying sustainability as a business opportunity or risk, to be "managed" so that "business as usual" can continue. Materiality can also narrow the scope of reporting, leading to issues omissions.

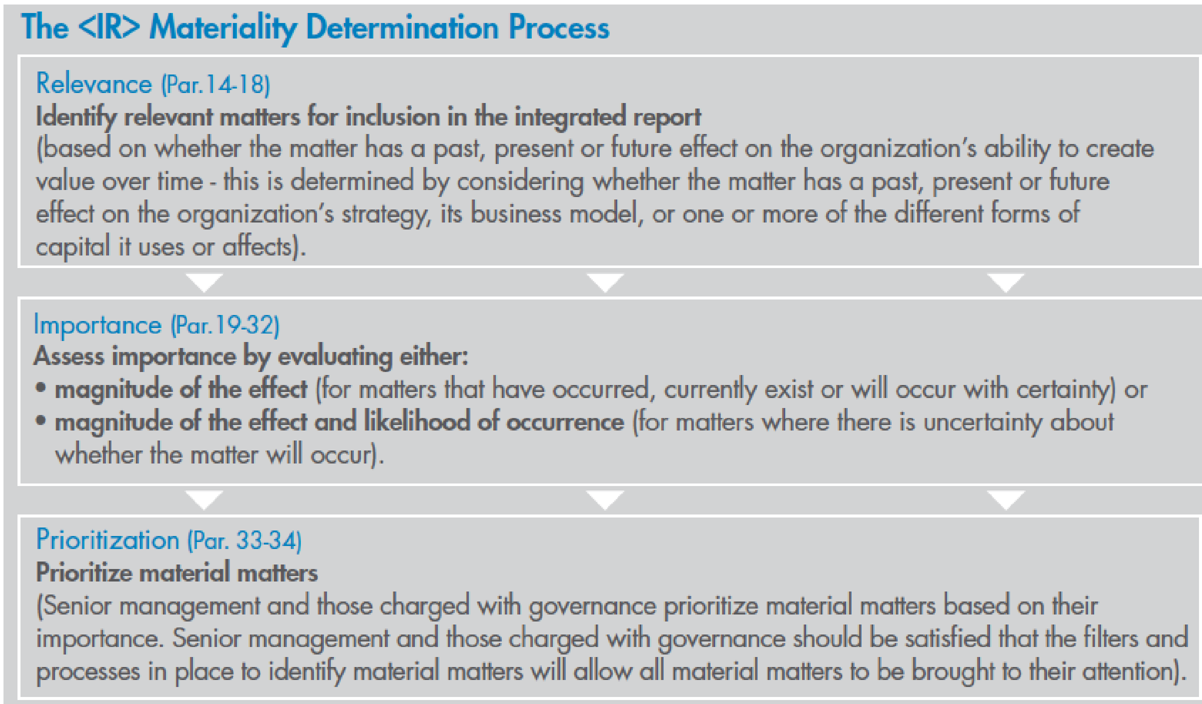
5.2 Materiality is a resource-intensive process (Sustainability, 2014) that raises concerns about disclosure of competitive sensitive information, future-oriented information and about the assurability of the materiality determination process (IIRC, 2013)

=> need of a periodic review of the materiality subjects and processes

6. Materiality process and detailed key steps of the process

Most frequent materiality processes

6.1 The Integrated Reporting suggests three phases in materiality determination: relevance, importance and prioritization.



The <IR> Materiality Determination Process

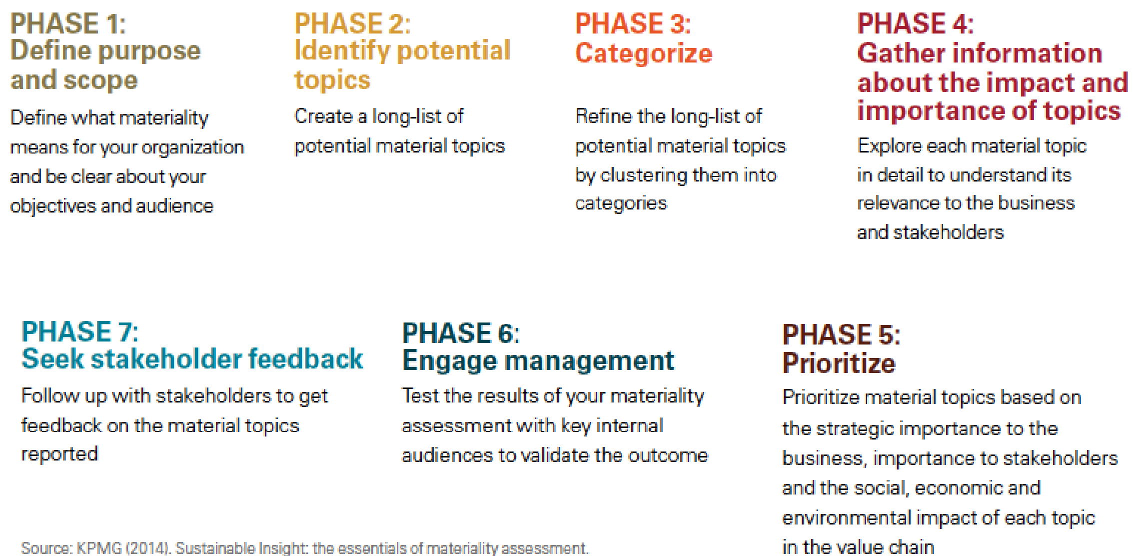
Relevance (Par. 14-18)
Identify relevant matters for inclusion in the integrated report
(based on whether the matter has a past, present or future effect on the organization's ability to create value over time - this is determined by considering whether the matter has a past, present or future effect on the organization's strategy, its business model, or one or more of the different forms of capital it uses or affects).

Importance (Par. 19-32)
Assess importance by evaluating either:
- **magnitude of the effect** (for matters that have occurred, currently exist or will occur with certainty) or
- **magnitude of the effect and likelihood of occurrence** (for matters where there is uncertainty about whether the matter will occur).

Prioritization (Par. 33-34)
Prioritize material matters
(Senior management and those charged with governance prioritize material matters based on their importance. Senior management and those charged with governance should be satisfied that the filters and processes in place to identify material matters will allow all material matters to be brought to their attention).

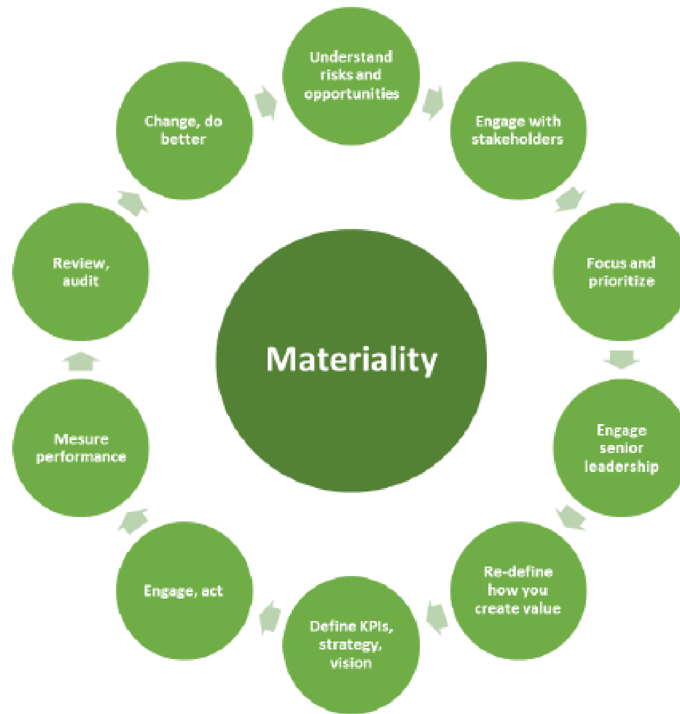
Source: IIRC, 2013, p. 3

6.2 KPMG (2014) proposes 7 phases from scope to seeking stakeholder feedback.

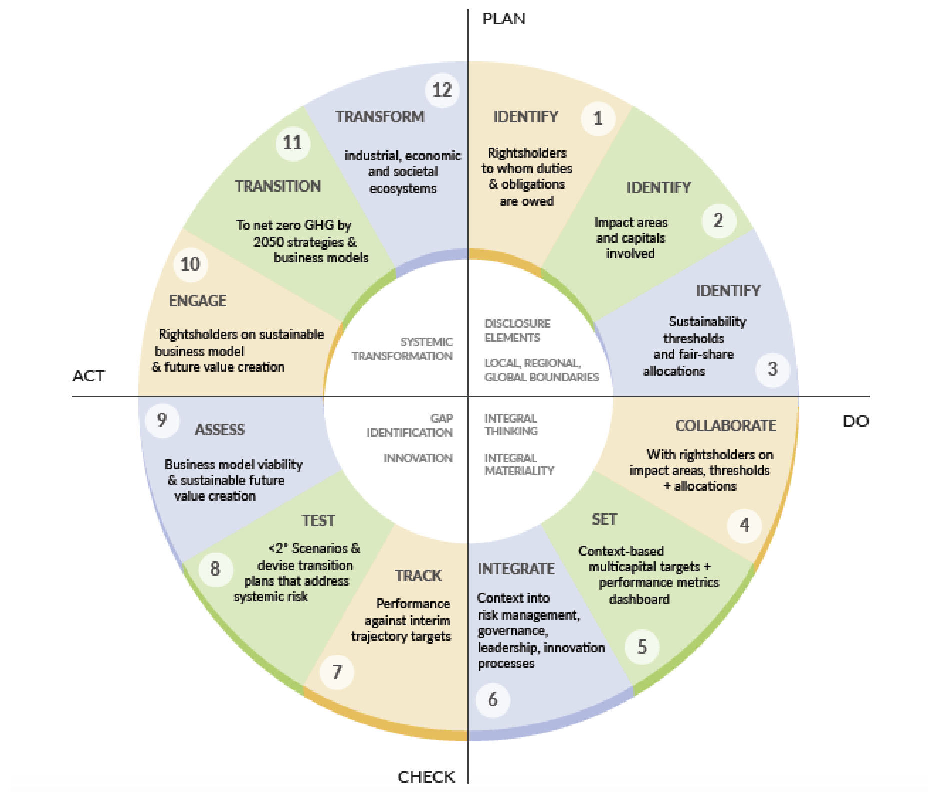


Source: KPMG (2014). Sustainable Insight: the essentials of materiality assessment.

6.3 Deloitte (2018) proposes three key steps: linking with risks and opportunities, engaging with the board, auditing.



6.4 R3.0 (2018) proposes to link materiality with context based multicapital targets and scenarios that include planetary boundaries.



6.5 WBCSD Reporting matters (2019, p.27) makes those recommendations in relation to materiality process:

- "Describe specific steps taken to identify, prioritize and validate material issues, including how you took the perspective of your organisation and key stakeholders into account;
- Include a range of factors when identifying and prioritizing issues, such as external trends, magnitude and likelihood of impacts, changes in materiality and alignment with enterprise risk management;
- Disclose a prioritized list of outcomes through a matrix or concise list of highly material issues;

Where appropriate, acknowledge divisional and geographical differences;

- Align the content of your report with outcomes of the materiality assessment, including strategy, targets, performance indicators, evidence of activities and details on implementation and control mechanisms;

- Demonstrate internal validation of the results of the materiality assessment; and

- Explain how third parties contributed to the assessment process or validation of outcomes"

Current processes are all based on specific and detailed analysis of the operational contexts of the company and may lead to identify specific key materiality topics closely dependent on the resulting judgements.

Engaging with the "right" stakeholders

6.6 According to Puroila and Mäkelä, (2019), "the identification of context-specific corporate stakeholders is a key issue for stakeholder engagement in materiality assessment". Elaine Cohen adds in her blog: "That is, of course, if you actually engage... and if you engage with stakeholders that are relevant. Not all stakeholders are created equal and not all should be represented with equal voice. Sending out a survey may sound like fun, and 500 responses may sound robust, but if the 500 voices are a random mix, and if the survey is the only tool you use, then it's quite possible that your outcome will not reflect a differentiating set of issues for your company."

6.7 One could refer to existing stakeholder engagement processes such as: **AA1000 Stakeholder Engagement Standard** (AA1000SES) 2015 from Accountability. It is the most widely applied global stakeholder engagement standard, supporting organisations to assess, design, implement and communicate an integrated approach to stakeholder engagement.

6.8 Deloitte (2018, p.25) suggests the following list of questions to select stakeholders:

- "How do they affect our organisation?
- How do they affect our approach to sustainability?
- How do we affect them?
- Do they have the power to enable and/or block our operations?
- Do they have knowledge, resources and technology relevant to us?
- Do they read our report? Our communications?
- Do we want them to read our communications and interact with us? And why?
- What is it that we want them to know, feel and do regarding our organisation?

  And how important is that to our short, medium and long term performance?
- What are the benefits of engaging with them or risks in not engaging with them?

- On a scale that begins with "Keeping them informed" moving up to "Making them close partners," how close does our relationship with each stakeholder group need to be?
- Is the relevance of that stakeholder group likely to change over time"?

Data and sources

6.9 Materiality analysis must engage with a variety of sources. For example, the Social and Human Capital Protocol states that you can engage with, in addition to your own analysis:

1/ Industry specific priorities

2/ National priorities (for example laws such as Modern Slavery Act or the Duty of Vigilance Law, or national SDG priorities)

Datamaran recommends to use "a larger universe of publicly available information representing stakeholder voices that can be analyzed - corporate filings, news, social media, policy maker initiatives and regulations, NGO white papers and campaigns, investors position papers, market authorities' codes." (Datamaran, 2018)

Finally, Deloitte (2018) suggests this list of external sources:

- CEPI's materiality report and related documentation
- International guidelines and sector specific reference frameworks (e.g. SASB, GRI sector supplements)
- NGO and sector specific sustainability frameworks (The state of the global paper industry 2018, Carbon Disclosure Index, the Forest 500, The New York Declaration on Forests, WWF's

Environmental Paper Company Index)

- CEPI's internal documentation and public reports
- CDP, Dow Jones Sustainability Index and other sustainability questionnaires
- UN Development Goals
- Industry specific publications
- Legal and reporting requirements
- Influential stakeholders' perspectives

Engagement of board

6.10 “Another unique feature of materiality for <IR> purposes is that the definition emphasizes the **involvement of senior management and those charged with governance in the materiality determination process** in order for the organisation to determine how best to disclose its unique value creation story in a meaningful and transparent way (IIRC, 2013)

Disclosure practices of materiality processes

6.11 <IR> recommendations are to:

- **“**Describe the process used to identify relevant matters
- Describe the process used to narrow down the relevant matters to material matters
- Identify the key personnel involved in (a) identification and (b) prioritization of material matters
- Identify the governance body with oversight responsibilities for <IR>.” (IIRC, 2013)

Those recommendations are also made by Datamaran (2018): “In order to be robust, a materiality analysis should be backed by data, and the evidence gathered should be used to prove that each issue has material implications for the company. There are different tests that can be carried out to prove an issue materiality. (…) Providing details on what tests have been applied to determine issues materiality is key for the analysis’ robustness and credibility”.

Annex: evolution of the concept of financial materiality

The notion of materiality returns to the idea of **discernment,** and has ancient roots in the history of law and management (Calace, 2019). Thus, ancient Roman law already included the principle of '*minima non curat praetor*' - where the law was not to concern itself with trivial matters (Formisano et al. 2018). In 1867, British case law introduced the term "material" by referring to a "relevant and not insignificant fact", while in 1895, in a resolution to update British company law, the committee in charge stated that "any contract or fact is material and may influence the judgment of a prudent investor in determining whether to subscribe to the share or obligation offered by the prospectus" (Holmes, 1972). This notion of "prudent investor" is also an essential element of the current definition of materiality adopted by the United States Supreme Court in 1976 ("*a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"*).

It was in 1967 that the concept found its first institutional translation in the field of accounting, *via* Accounting Recommendation 2.301 of the *Institute of Chartered Accountants in England and Wale*. Materiality was thus built on assemblages of historical conditions, with changing chronological and sectoral meanings justifying, for example, the FASB's work in 1975 to arrive at operational definitions (*Criteria for Determining Materiality*). In 1980, in the *Statement of Financial Accounting Concepts* No. 2, the FASB introduced a more flexible definition based on "surrounding circumstances", thus giving the concept of materiality the character of a social construct: "*the magnitude of an omission or misstatement of accounting information that, in the light of the surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the Information would have been changed or influenced by the omission or misstatement*".

Recognizing the heterogeneity of definitions of materiality, ISA 320[4] did not attempt to define materiality, but stated that "*[financial reporting frameworks] generally explain that: misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements; judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement, or a combination of both*. Also, until recently, the definition of materiality applied by the IASB was: "Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements" (IASB, 2010). In 2018, the definition of what is "material" in financial statements was clarified by the IASB as follows: *"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*

[4] International Standard on Auditing on the Consideration of "Materiality in Planning and Performing an Audit".

make on the basis of those financial statements, which provide financial information about a specific reporting entity".

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