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This report explores the concept of materiality for sustainability reporting, with reference to how materiality is defined across prominent sustainability reporting standards.

The concept of materiality for sustainability reporting – Transparency, and by implication, effective reporting and disclosure, is a cornerstone of good governance.

Purpose

An organisation develops its strategy, priorities and associated key performance indictors – preferably in the triple context of social, economic and environmental performance – in managing the performance of the organisation. Being transparent about its performance and the progress over time in this regard, as well as on other key priorities, is important to allow stakeholders to make an informed decision on the performance of the organisation and its long-term value creation over the short, medium and long term. Disclosure and reporting should therefore be informed by these priority matters – the so-called material matters – and in this regard, organisational leadership needs to determine what is material for reporting. This will depend on the particular circumstances or environment in which an entity operates.

It is important to distinguish between the concept of materiality as it refers to financial reporting, and the concept of materiality within the context of sustainability reporting. In respect of financial reporting, information is deemed material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. In the sustainability context, the term materiality refers to those issues that can have significant positive and / or negative impact on the company [7]. For sustainability reporting, in order to determine what is material, report preparers should have regard to performance in areas beyond financial

Purpose

performance and in the context of what is material both quantitatively and qualitatively. This may include consideration, inter alia, of what is important for the organisation in achieving its purpose and progress made in this regard and consideration of material matters that may impact the organisation and / or its stakeholders and the environment.

For example:
"The issue of water scarcity is generally considered to be a material issue for beverage companies like PepsiCo. PepsiCo relies on water to produce its products, and without a consistent supply of inexpensive water, would likely face significant business challenges. Because other people rely on the same water resources, PepsiCo may face pressure from stakeholder groups who object to its sourcing of water from communities in water-stressed regions.

Thus, water scarcity is a material issue to PepsiCo's corporate and sustainability efforts because:

- *The company's sales and profitability are at stake should water become scarce or economically unavailable*
- *The company's actions impact water availability (i.e., PepsiCo takes water from communities that may rely on it for other purposes)*
- *Stakeholder groups care about water scarcity and PepsiCo's policies and management of the issue."*

Guidance has been developed by various standard setters to assist organisations in making materiality assessments for sustainability reporting and differing approaches are provided whereby materiality is determined with reference to either or both of impact and audience. In respect of impact, this approach considers the impact on the organisation only ('single materiality') or the impact on the organisation as well as the impact on people, the environment and the economy ('double materiality'). In respect of audience, this approach considers what is relevant depending on who the primary audience is.

This report considers the concept of materiality for sustainability reporting with reference to how materiality is defined across prominent sustainability reporting standards and provides insight into the materiality process and important considerations in the assessment thereof.

(P. 2, NYU Stern Centre for Sustainable Business: Sustainability Materiality Matrices Explained – NYU Stern Centre for Sustainable Business [7])

Background

Why is materiality important in corporate reporting?
The concept of materiality originated in accounting and financial reporting. The International Accounting Standards Board (IASB) defines "material" information as that which, if omitted, misstated, or obscured, could influence the economic decisions of readers relying on the financial statements. The concept has subsequently been borrowed, adapted and applied to non-financial information and in sustainability reporting which extends to the reporting of matters relating to the economy, society and environment.

When assessing materiality for reporting purposes, organisations need to consider a range of facts and circumstances, including both quantitative factors (for example, the quantum involved) and qualitative factors (for example, the specific circumstances within and outside of the organisation) [11]. When the concept of materiality is not applied appropriately it may result in disclosure of too much information, too little information or non-disclosure of pertinent factors altogether. A major challenge is that materiality is, by its very definition, context dependent. That means that material sustainability issues vary across sectors, and even across individual organisations. Organisational leadership needs to assess materiality based on the organisation's overall operating context, while also identifying the unique risks and opportunities for each of their operating locations.

This subjective nature of materiality assessment for sustainability reporting purposes has led to the development of definitions and accompanying processes by various standard setters to identify what is material. This reflects the different intended purpose and outcomes of the respective standard-setter.

Sustainability reporting
There is no single definition of "sustainability reporting". Multiple frameworks, guides and codes of best practice have emerged which deal with how organisations should be managing and/or reporting on more than just their financial performance and the financial returns generated for providers of debt and equity. Examples include the "GRI Standards", the "Integrated Reporting Framework" and the "Task Force on Climate-related Financial Disclosures".

The broadest sustainability reporting covers all economic, environmental and social matters which are necessary for understanding an organisation's positive and negative contributions to sustainable development[1]. This information would be prepared for a wide group of users rather than being focused primarily on investors and creditors [5].

Alternately, an organisation may choose to cover those matters which impact enterprise value. Enterprise value is the total value of the entity's equity and net debt. It is based on the amount, timing and risk inherent in an entity's projected cash flows. Information in a sustainability report focused on enterprise value is prepared for investors and creditors who use this information, as well as information contained in financial statements, to estimate future cash flows. As a result, the information is financial in nature in that it contextualises economic, environmental and social matters in financial terms rather than dealing with direct economic, environmental and social impacts [5]. This type of reporting is referred to as "sustainability-related financial reporting". Under this approach, it is assumed that satisfying the information needs of the providers of debt and equity using sustainability-related financial disclosures automatically addresses other users' information needs.

What are the different forms of materiality currently being promoted in sustainability reporting?
Impact materiality focuses on the external 'inside-out' impacts an organisation's own operations and its value chain have, including impacts on economy, environment and people. As per the draft ESRS 1: General Requirements[2], a sustainability matter is material from an impact perspective if it is connected to actual or potential significant impacts by the organisation on economy, environment and people over the short-, medium- or long-term. This includes impacts directly caused or contributed to by the organisation in its own operations, products or services and impacts which are otherwise directly linked to the organisation's upstream and downstream value chain, and not limited to contractual relationships [4]. The GRI places emphasis on economic, environmental and social impact and is an example of a sustainability reporting framework whose materiality approach is based on this notion of "impact materiality". That is, information is material if it affects stakeholders' understanding of an organisation's economic, environmental or social impact [1].

Background

The primary focus of the International Sustainability Standards Board's (ISSB) proposed IFRS Sustainability Disclosure Standards[3] will be on those sustainability issues impacting the organisation. This is known as financial materiality (sometimes referred to as 'single materiality') or an 'outside-in' perspective and is focused on issues that impact an organisation's financial performance and its ability to create economic value for investors and shareholders [2]. While the IFRS Standards are still in development, the ISSB has indicated it will fully align its description of materiality with the IFRS Accounting Standards, i.e., financial materiality. The ISSB plans to explain the interconnected relationship between value created for the company and value created for its stakeholders and how value created for a company's stakeholders (its impacts) can affect the availability of resources and the quality of relationships on which the company depends, which in turn gives rise to sustainability-related risks and opportunities that can affect its performance or prospects. Risks and opportunities often arise from the impacts that the company's activities have on its stakeholders. This means that information about these impacts may be material for its sustainability-related financial disclosures. Information about other stakeholder impacts – i.e., those that do not give rise to risks and opportunities that are relevant for investors and creditors – is less likely to be material under the ISSB's proposed Standards [9].

When an organisation reports on its economic, environmental and social impact and enterprise value, impact and financial materiality must be considered concurrently. This is referred to as using "double materiality". Reporting on enterprise value may be interconnected or overlap with reporting on economic, environmental and social impact. In these cases, impact and financial materiality will also be interconnected [6]. The relevance and inter-connectedness of both financial and impact materiality is the reason for the growing importance of the concept of double materiality, which combines both perspectives. As the GRI, puts it: "Financial materiality and impact materiality together under the umbrella of 'double materiality' are the only relevant forms of materiality, with both perspectives needed in a two-pillar structure - for financial and sustainability reporting - with a core set of common disclosures and each pillar on an equal footing.[4]"

How is materiality being approached in international sustainability reporting standards?

The Global Reporting Initiative (GRI) takes a stakeholder-focused approach. This aligns with the aim of preparing sustainability reports which deal with an organisation's economic, environmental and social impact for a broad group of users rather than more narrowly on enterprise value primarily for the benefit of providers of debt and equity.

"An organization is faced with a wide range of topics on which it can report. Relevant topics, which potentially merit inclusion in the report, are those that can reasonably be considered important for reflecting the organization's economic, environmental, and social impacts, or influencing the decisions of stakeholders. In this context, 'impact' refers to the effect an organization has on the economy, the environment, and/or society (positive or negative). A topic can be relevant – and so potentially material – based on only one of these dimensions" (GRI, 2016, p. 10 [1]).

"A combination of internal and external factors can be considered when assessing whether a topic is material. These include the organization's overall mission and competitive strategy, and the concerns expressed directly by stakeholders. Materiality can also be determined by broader societal expectations, and by the organization's influence on upstream entities, such as suppliers, or downstream entities, such as customers. Assessments of materiality are also expected to take into account the expectations expressed in international standards and agreements with which the organization is expected to comply" (GRI, 2016, p. 10 [1]).

1 Development which meets the needs of the present without compromising the ability of future generations to meet their own needs. (World Commission on Environment and Development. "Our Common Future". Oxford, 1987)

2 ESRS Standards (ESRS 1: draft standard) are still in development and subject further modification or clarification

3 IFRS Sustainability Disclosure Standards are still in development; subject to dealing with comments received on the consultation process during 2022 these standards may be modified or further clarified

4 Extracted from page 2: https://www.globalreporting.org/media/r2oojx53/gri-perspective-the-materiality-madness.pdf

Background

Materiality in the GRI (Global Reporting Initiative) Standards requires organisations to report on topics that "that represent an organisation's most significant impacts on the economy, environment, and people, including impacts on their human rights"[5]. In the GRI's materiality assessment process, the starting point to identify material issues is the impact (actual and potential) that the organisation's business activities can have on the economy, the environment, and people, including human rights impacts; given the organisation's context.
As such, the GRI advocates for an assessment that considers all impacts (including operational, reputational, or financial).
The GRI Standards provide an example of a reporting framework focused on impact reporting for a multi-stakeholder audience, aligning to the concept of impact materiality [1].

In its draft Standards issues in early 2022, the International Sustainability Standards Board (ISSB) proposed that sustainability reports should allow primary users to assess an organisation's enterprise value. Information is material if:

"omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reporting make on the basis of that reporting, which provides information about a specific reporting entity" (IASB, 2022, Appendix A [2])

The IFRS Foundation's focus is on meeting the information needs of investors. The intention is for the ISSB's Standards to require companies to provide all material information related to significant sustainability matters that are relevant to investors' decision-making, including thematic and industry-based requirements. The information needed by investors about the effects of sustainability extends beyond information included in the financial statements. Such information would include forward-looking sustainability matters that are reasonably possible to affect enterprise value creation, preservation or erosion over the short, medium and long term—which therefore would impact investors' investment decisions [2].
After a consultation process on the draft ISSB's standards, the ISSB has confirmed their focus on investor's views i.e., enterprise value materiality lens although the revised wording and definitions in the Standards are only expected in June 2023. The ISSB has released some insight into its clarification of the concept of sustainability, clarifying that "a company's ability to deliver value for its investors is inextricably linked to the stakeholders it works with and serves, the society it operates in, and the natural resources it draws on". Sustainability will be described in the ISSB's General Sustainability-related Disclosures Standard (S1) as the ability for a company to sustainably maintain resources and relationships with and manage its dependencies and impacts within its whole business ecosystem over the short, medium and long term. Sustainability is a condition for a company to access over time the resources and relationships needed (such as financial, human, and natural), ensuring their proper preservation, development and regeneration, to achieve its goals [9].

The European Union has created its European Sustainability Reporting Standards (ESRS) which is based on double materiality, for a multi stakeholder audience (which including investors).
The latest ESRS draft also states that "double materiality has two dimensions, namely impact materiality and financial materiality…a sustainability matter is material for the undertaking when it meets the criteria defined for impact materiality or financial materiality or both.[6]" [4]

The IIRC[7] requires sustainability reports to "disclose information about matters that substantively affect the organization's ability to create value over the short, medium and long term" [3]. Value is created for the organisation itself as well as for stakeholders (including debt and equity providers). As a result, the sustainability report covers the organisation's economic, environmental and social matters (aligned with a broad approach to reporting) as well as the matters which affect enterprise value [5]. This is in keeping with an integrated approach to reporting which treats economic, environmental and social factors as interconnected and the position that an organisation's ability to generate value for itself is dependent on the value created for stakeholders.

5 Extracted from GRI 3: Material Topics 2021 which is applicable to reports or materials published on or after 1 January 2023.
6 ESRS 1: General Requirements (Paragraph 31 and 40)
7 Note that the IIRC has been subsumed into the Value Reporting Foundation which has, subsequently, been taken over by the IASB. The IIRC's framework is, however, still available on the IASB's webpage.

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For example, the IIRC states that materiality determination is "integrated into the organization's management processes and includes regular engagement with providers of financial capital and others" [3]. Materiality is not, however, understood in only financial terms because value generation for investors and creditors will be dependent on value generated for other stakeholders. Impact materiality is an equally important aspect of the application of an implicit double materiality logic.

From a South African perspective, the JSE's Sustainability Disclosure Guidance for listed companies (launched in June 2022) aims to improve the quality and availability of information both for investors, focusing on the sustainability-related risks and opportunities that affect the entity's financial performance, namely the 'outside-in' perspective, as well as for stakeholders more broadly, covering disclosure on the reporting entity's significant impacts on the economy, society and environment, namely the 'inside-out' perspective. As such, this disclosure guidance addresses both impact materiality and financial materiality, as per the concept of double materiality outlined earlier in this FAQ. The Guidance draws on the various sustainability reporting frameworks and emphasises the importance of the report's audience in assessing materiality [12].

Conclusion

Defining what is and is not material to report on to stakeholders can often be complex and challenging, at times, exacerbated by the different approaches that standards take to assess materiality for sustainability reporting. In practice, the range or scope of sustainability reporting varies. Not all organisations may fit neatly into one of the materiality approaches outlined in this paper and organisations can report broadly on some matters and more narrowly on others. Differences in the scope of reporting are the result of, inter alia, how organisations understand the purpose of sustainability reporting, the users being targeted, regulatory requirements, industry trends and stakeholder expectations. The availability of information is a particularly relevant consideration. Information which deals with financial impacts of social and environmental matters may be more readily available from traditional accounting systems than a broader body of information covering direct social and environmental impacts on different stakeholders. When dealing with the former, the information will be in a single unit of measure and probably quantitative. When dealing with the latter, data will be measured in different units and the likelihood of encountering a mix of qualitative and quantitative information is greater.

Given these variances, and the impact it has on reported information and how the results should be interpreted by users of the report information, it is essential for organisations to be clear and transparent around their materiality approach and processes applied when reporting internally and externally. This is an important indicator of governance applied in respect of the materiality reporting determination and assessment processes. From a South African perspective, Principle 5 of the King Report on Corporate Governance for South Africa™ prescribes that a governing board should ensure that reports issued by the organisation enable stakeholders to make informed assessments of the organisation's performance, and its short-, medium- and long-term prospects. Some of the pertinent King IV™ recommended practices in support of Principle 5, and which are relevant to the matter of materiality for reporting purposes, include:

- Approving management's determination of the reporting frameworks to be used, whilst considering legal requirements, the intended audience and purpose thereof;
- Ensuring that the annual financial statements, sustainability reports, social and ethics committee reports, or online printed information and reports comply with legal and regulatory requirements and/or meet the legitimate and reasonable information needs of material stakeholders;
- Approve management's bases for determining materiality for the purpose of deciding which information should be included in external reports; and
- Ensure the integrity of external reports. [13]

In considering the appropriate materiality approach for sustainability reporting by the Board and management, A4S's Reporting Insight's document provides a set of questions triggering a thoughtful and considered basis for an organization's materiality determination and assessment processes:

"Questions:

1. Has your organization clearly defined what materiality means to you, and documented this?
2. Have you identified key stakeholders for sustainability reporting and undertaken a consultation with them to determine material issues and relevant environmental and social metrics?
3. For sustainability metrics reported and disclosed externally, are you regularly reporting these internally and do they form part of the decision-making process?
4. Is your approach and assessment of materiality clearly disclosed in your external reporting with sufficient detail to enable report users to understand the judgements made?
5. Have you clearly established that your sustainability materiality assessment is in compliance with requirements and guidance from the frameworks and standards you are adopting?"

(Pg 3. Accounting for Sustainability. 2022. A4S Reporting Insights Sustainability Materiality and Metrics.[8])

As the concept of materiality for sustainability reporting continues to evolve, as directed by the imminent finalization and implementation of various sustainability reporting standards, the dynamic nature of materiality must also be factored into materiality considerations. The emerging concept of dynamic materiality acknowledges that an issue or impact can materially change over time, along a sliding scale and therefore takes a forward-looking, adaptive and proactive approach when assessing materiality for decision-making and reporting purposes. Articulating the time horizons used and how frequently materiality topics will be reviewed should be central to any robust materiality assessment process. This would include reviewing the links to company risks, opportunities and strategy and assessing how this connectivity is reflected in reported information such as key performance indicators (KPIs), management discussion and comparability of information [10].

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