



# MATERIALITY

BACKGROUND PAPER FOR <IR>



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## Background and overview

1. Materiality is a matter that has been debated extensively in the context of many forms of reporting. In this Background Paper, which explores the concepts of materiality for purposes of developing an International Integrated Reporting <IR> Framework, we will:

- Define materiality for Integrated Reporting <IR> (specifically distinguishing it from materiality as it relates to financial reporting and sustainability reporting)
- Discuss the importance of materiality
- Discuss the application of the materiality determination process in <IR>
- Discuss disclosure considerations in an integrated report
- Discuss potential constraints in the current environment.

2. <IR> is a process that results in communication, most visibly a periodic “integrated report”, about value creation over time. An integrated report is a concise communication about how an organization’s strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term.<sup>1</sup>

3. The materiality definition for <IR> purposes considers the commonality of materiality definitions from various reporting frameworks<sup>2</sup> and, in particular, the notion that material matters are those that are of such relevance and importance that they could substantively influence the assessments of the intended report users. Where the various materiality definitions differ the most is in terms of the matters that are considered to be relevant. In the case of <IR>, relevant matters are those which affect or have the potential to affect the organization’s ability to create value over time. For financial reporting purposes, the nature or extent of an omission or misstatement in the organization’s financial statements determines relevance. In the context of sustainability reporting, an organization’s economic, environmental and social effects and the effect of the legal, commercial, social, environmental and political context on that organization are considered in determining what is relevant. Matters that are considered material for financial reporting purposes, for sustainability reporting, or for other forms of reporting may also be material for <IR> purposes if they are of such relevance and importance that they could change the assessments of providers of financial capital with regard to the organization’s ability to create value.

4. 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 organization to determine how best to disclose its unique value creation story in a meaningful and transparent way.

## Context for the definition

5. An organization’s ability to create value over time depends on many factors, including the organization’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.

## Intended users of integrated reports

6. While the communications that result from <IR> will be of benefit to a range of stakeholders, they are principally aimed at providers of financial capital in order to support their financial capital allocation assessments. Providers of financial capital are therefore the primary intended users of integrated reports. Those providers of financial capital who take a long term view of an organization’s performance are particularly likely to benefit from <IR>. The interests of such providers are likely to be aligned with the public interest in that both are focused on the creation of value in the long term, as well as the short and medium term. Activities and strategies that are overly focused on optimizing short term financial performance on the other hand, can impede the ability of organizations and providers of financial capital to make long term investments. These include investments in research aimed at long term innovation and in the infrastructure needed to address

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<sup>1</sup> Any references to ‘over time’ refer to ‘over the short, medium and long term’.

<sup>2</sup> Refer to Appendix 4 for a listing of materiality definitions considered.

mounting global challenges, such as resource shortages as planetary limits are approached, economic instability, climate change, and changing demographics and societal expectations.

7. In serving the information needs of providers of financial capital, the report may also provide insight into the organization's relationships with its key stakeholders, and how and to what extent the organization understands, takes into account and responds to their needs and concerns.

### Definition of materiality

8. For the purposes of <IR>, a matter<sup>3</sup> is material if it is of such relevance and importance<sup>4</sup> that it could substantively<sup>5</sup> influence the assessments of providers of financial capital with regard to the organization's ability to create value over the short, medium and long term. In determining whether or not a matter is material, senior management and those charged with governance should consider whether the matter substantively affects, or has the potential to substantively affect, the organization's strategy, its business model, or one or more of the capitals<sup>6</sup> it uses or affects.<sup>7</sup>

### Importance of materiality

9. Materiality plays a crucial role in determining the matters to be included in an integrated report and ensuring conciseness of the report. Materiality and conciseness form one of the 6 Guiding Principles that inform the content and presentation of an integrated report, as well as the process through which it is prepared.

### The materiality determination process

10. Determining materiality for purposes of preparing an integrated report involves:

- identifying relevant matters,
- assessing the importance of those matters in order to determine their ability to substantively influence assessments about the organization's ability to create value over time and
- prioritizing the matters identified

(hereinafter referred to as the "<IR> materiality determination process").

### Those responsible for the process

11. Application of the <IR> materiality determination process requires a high degree of judgement and involves numerous strategic considerations. This requires senior management and those charged with governance collectively to exercise judgement to determine which matters are material for purposes of <IR> and to ensure that they are appropriately disclosed given the specific circumstances of the organization, including the application of generally accepted measurement and disclosure methods as appropriate.

### Application of the <IR> materiality determination process

12. The <IR> materiality determination process is illustrated in the following diagram, which is to be read in conjunction with the text that follows. The process applies to both positive and negative matters (e.g., opportunities and risks, favourable and unfavourable results or prospects for the future) and to financial and other information. Such matters may have direct implications on the organization itself or relate to the organization's effects on the capitals, including those available to others.

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<sup>3</sup> A matter or information includes, but is not limited to, an event, issue, opportunity, amount, or statement by the organization.

<sup>4</sup> Importance refers to both nature and magnitude.

<sup>5</sup> The dictionary definition of the word "substantive" means having a firm basis in reality and being therefore important, meaningful, or considerable.

<sup>6</sup> Forms of capital refer to the organization's resources and relationships and include financial, manufactured, human, intellectual, natural, and social and relationship capital.

<sup>7</sup> The definition of materiality and this Background Paper for <IR> as a whole should be read in conjunction with the Prototype Framework available at [www.theiirc.org](http://www.theiirc.org) and the Background Papers for <IR> on Value, the Business Model and the Capitals.

## 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).

13. Materiality assessments should be performed at least annually; however, for the <IR> materiality determination process to be applied most effectively, it should ultimately be integrated into the everyday management of the organization as part of a continuous process of review and assessment of matters by senior management and those charged with governance.

## Relevance

14. Relevant matters for <IR> purposes are those matters that have 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.

15. The identification of relevant matters is the starting point for identifying material matters that will be disclosed in an integrated report. Relevance is not considered to be a subset of materiality; relevance simply plays a role in the process of identifying material matters. Once relevant matters have been identified, the importance of the matter and thus the ability of the matter to substantively influence assessments will be evaluated as discussed below in the Importance section.

16. In order to identify relevant matters, senior management would (at a minimum):

- consider the organization's value drivers<sup>8</sup>;
- consider matters identified during stakeholder analysis and engagement (where appropriate the organization may engage with key internal stakeholders (e.g., employees) and external stakeholders (e.g., investors, customers, suppliers, local communities, NGOs, and governments) in order to understand stakeholder interests and concerns and to further consider the organization's dependencies and effects (both positive and negative) on the capitals);  
(For additional guidance on stakeholder engagement refer to Appendix 1)

<sup>8</sup> Value drivers are capabilities or variables that give an organization competitive advantage and over which it has some degree of control so as to create value. They may include:

- Financial drivers such as growth in sales or market share, pricing strategy, operational efficiency, brand equity and cost of capital
- Other drivers such as customer relations, societal expectations, environmental concerns, innovation and corporate governance
- Values such as integrity, trust and teamwork that support value creation.

Value drivers alone and in combination affect an organization's ability to create value over time.

- consider other factors external to the organization (these include, macro and micro economic changes, market forces, the speed and effect of technological changes, societal issues, environmental challenges, the legislative and regulatory environment, and matters identified by the organization's risk management process);
- consider other factors internal to the organization, including the organization's capacity to exert leverage on its relationships and the organization's competence/capacity to respond to changing conditions;
- consider the organization's performance in the current business reporting cycle<sup>9</sup>; and
- ultimately, consider whether the matters identified in the preceding five points affect or may affect the organization's strategy, its business model or the capitals, and thus affect the organization's ability to create value over time.

17. As part of the process of identifying relevant matters for <IR> purposes, it is important that long term matters not be overlooked. Matters that might be relatively easy to address in the short term but which if left unchecked could be increasingly damaging and progressively more difficult to address over time need to be included in the population of relevant matters.

18. Comparing matters identified with those being reported on by organizations 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 organization does not wish to address them or does not know how to deal with them.

## Importance

19. Not all relevant matters will be considered material for <IR> purposes. In order for relevant information to be included in the integrated report, the information also needs to be of significant importance in terms of its known or potential effect on value creation. It is thus necessary to determine the importance of the matters identified as relevant for <IR> purposes in order to identify those matters that are material and thus warrant inclusion in the integrated report.

20. Some matters will be certain (for example, historic, or those mandated by regulation). For these matters, importance is determined by assessing the magnitude of the matter's effect on the organization's ability to create value over time. However, if it is uncertain whether the matter will occur (for example, future events), the matter's importance is determined by reference to both the magnitude of the matter's estimated effect and its likelihood of occurrence. A matter's importance should be evaluated on a gross basis (i.e., the unmitigated negative effect of a risk). If the matter is determined to be of such importance that it has the potential to substantively influence assessments, the matter is considered material for disclosure purposes.

## Assessing the magnitude of the effect (for matters with no uncertainty of occurrence)

21. For matters with no uncertainty of occurrence (i.e., matters that have already occurred, matters that currently exist (e.g., the organization's culture, management style, internal systems) and those matters that will definitely occur in the future (e.g., an enacted law that will become effective at a future date)) only the magnitude of the effect needs to be assessed to determine the importance of the matter for <IR> purposes.

22. Magnitude of the effect refers to the magnitude of the matter's effect on the organization's ability to create value over time. An understanding of the perspectives of the broader stakeholder group is critical to this assessment because stakeholder actions have the potential to affect an organization's ability to create value.

23. The magnitude of the effect on an organization's ability to create value is assessed by considering the magnitude of the matter's effect on the organization's strategy, its business model, and the capitals over time in order to determine whether the matter is of such importance that it has the potential to substantively influence assessments.

24. The manner in which the magnitude of a matter's effect is assessed requires judgement and will depend on the nature of the matter in question. Assessing the magnitude of the matter's effect does not imply that the effect

<sup>9</sup> Current business reporting cycle refers to the financial year end that the organization is in the process of reporting on. The organization's business reporting cycle may differ from its business cycle.

needs to be quantified. Depending on the nature of the matter, a qualitative assessment may be more appropriate. For example, it may not be possible or necessary to quantify the effect of a matter on the organization's strategy. If a matter causes the organization to change one or more of its strategic objectives, it likely would be considered important and quantification might not be necessary.

25. In assessing the potential magnitude of the effect on the organization's ability to create value over time, the organization should, at a minimum, consider quantitative and qualitative factors; financial, operational, strategic, reputational and regulatory perspectives of the effects; the area of the effect (internal and external to the organization); and the timeframe of the effect. Examples of each of these factors are provided below:

#### 1. Quantitative and Qualitative Factors

- Quantitative factors may be measured by financial effects but could often extend to non-financial measures (e.g., percentage of production or sales volume, percentage of total capacity or resources, percentage yield or efficiency factors) and may often be sector specific.
- Qualitative factors may include matters that would affect the organization's social and legal licence to operate or matters that affect the availability, quality and affordability of the capitals the organization uses or affects (e.g., matters affecting reputation and credibility such as regulatory infringements, major fraud/corruption and sensitive factors like fatalities, pollution, unemployment, or negative economic effects).

#### 2. Financial, operational, strategic, reputational and regulatory perspectives of the effect

- Financial perspectives may be measured in monetary terms but could extend to financial ratios (e.g., gross margin, gearing, liquidity ratios or credit risk).
- Operational perspectives typically pertain to operational aspects of the organization (e.g., consumer goods – market share, telecoms – customer churn<sup>10</sup> rate, mining – yields and production volume).
- Strategic perspectives relate to the high-level aspirations of the organization (e.g., its ability to achieve and sustain safety performance levels, sustained and growing market share leadership, margin growth or retention, R&D pipeline and product pipeline development).
- Reputational perspectives refer to impact assessments of incidents or events that may affect the reputation of the organization (e.g., late recall of a defective product posing significant consumer health risk, or cancellation of airline flights due to grounding or failure to pay suppliers) and in extreme cases may ultimately affect the organization's social licence to operate.
- Regulatory perspectives refer to the organization's legal licence to operate (e.g., infringement of civil or criminal regulations and resultant penalties or reputational effects).

Note that not only do the financial perspectives affect future cash flows, but so too do the operational, strategic, reputational and regulatory perspectives.

#### 3. Area of the effect

- Internal (within the organization) – 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 organization) – Effect on external stakeholders and how this reverts back to pressure back on the organization through enhanced or diminished organizational reputation (e.g., an oil spill in the ocean), or the availability, affordability and quality of capitals upon which the organization relies (e.g., the availability of clean water).

#### 4. Time frame of the effect

- 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

<sup>10</sup> Customer churn, also referred to as customer turnover or customer attrition, refers to the loss of clients or customers.



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).

Note that the typical time frames referred to above may differ by industry or sector; for example, strategic plans in the automobile industry typically cover two model cycle terms, spanning between eight and ten years, whereas within the IT industry, timeframes may be significantly shorter. In addition to varying by industry, what is considered short, medium or long term may be influenced by the organization’s investment cycle, strategies and stakeholder expectations.

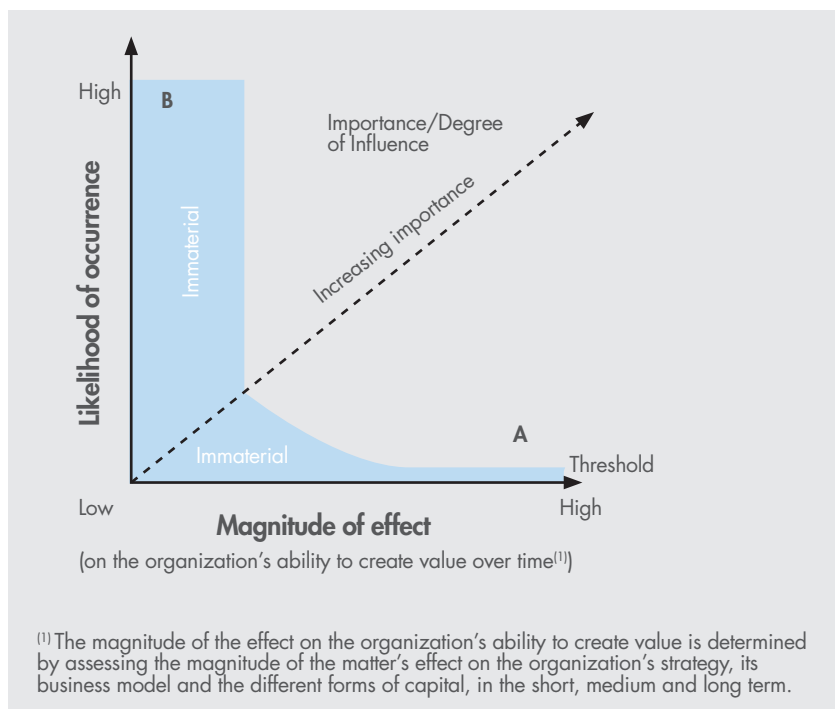
26. If, after assessing the magnitude of the matter’s effect it is determined that the matter has the potential to substantively influence assessments about the organization’s ability to create value over time, the matter is considered material and needs to be disclosed. If the matter does not have the potential to substantively influence such assessments, it is not considered material and no disclosure is made in the integrated report.

#### Assessing the magnitude of the effect and the likelihood of occurrence (for matters with uncertainty of occurrence)

27. Where it is uncertain whether a matter will occur (e.g., a matter that may occur in the future or have potential future effects), both:

- the magnitude of the effect<sup>11</sup> and
- the likelihood of occurrence

are considered to assess importance for <IR> purposes. The following diagram illustrates how the importance of such matters can be assessed and should be read in conjunction with the text that follows it. The diagram applies to the analysis of both positive and negative effects of future-oriented matters.



<sup>11</sup> Note that the manner in which the magnitude of the effect is assessed is the same as that described in the “Assessing the magnitude of the effect” section.

28. Matters with a high likelihood of occurrence and a large effect would have a greater degree of influence on assessments than matters with a lower likelihood of occurrence or smaller effect. As illustrated in the above diagram, the importance of a matter with a large effect and a low likelihood of occurrence (point A) is greater than a matter with a high likelihood of occurrence and a small effect (point B), since the former matters, should they occur, could severely affect the organization's ability to create value over time. Assessments of these matters are made qualitatively rather than merely by considering estimated quantifications of the effects (such as might be calculated by multiplying the likelihood by the magnitude).

29. If it is determined that the likelihood of occurrence and the potential magnitude of the effect of the matter is of such importance that the matter has the potential to substantively influence assessments about the organization's ability to create value over time, the matter is considered material and needs to be disclosed. If not, the matter is not considered material for purposes of <IR> and is not disclosed in the integrated report.

30. There may be instances where the magnitude of a matter's effect or likelihood of occurrence cannot be determined. This does not imply that the matter is not material for <IR> purposes. Such matters may in fact be material and therefore could require substantial judgement in assessing their importance. It is essential that such matters are not excluded simply because their importance cannot be easily estimated.

#### Factoring in the compounding effect of unaddressed matters into the evaluation of importance

31. As part of the overall assessment of the importance of a matter for <IR> purposes, the compounding effect of unaddressed matters should be considered. Certain matters that appear to be of low importance in the short or medium term, and do not diminish over time, have the potential to increase substantially in importance if the matters remain unaddressed. Since <IR> covers not only the short and medium term but also the long term, the compounding effect of not addressing such matters needs to be considered to ensure that the appropriate level of importance is attributed to them.

32. The following example illustrates the materiality considerations associated with safety in the mining industry:

Safety in mining is almost always considered a material issue and the extent of its effect will often depend on the inherent risks of the type of mining operations undertaken (e.g., quarry, open cast, deep mining).

Safety incidents are managed on a continuous basis and would typically be seen to affect the current business model and capitals for incidents and trends that have occurred and materially affect the future business model and capitals for incidents that could potentially occur in the future.

The likelihood of safety incidents are considered relative to a number of factors, which could include:

- Seismic activity and geological conditions that could lead to safety incidents
- Industry experience and trends with that type of mining application or operation
- Current technologies and methods of mining used in different mining applications
- Risk analysis of "what could go wrong" and factors that would contribute to occurrence of risk.

It is important to stress that likelihood is considered at the inherent risk level before the effect of mitigation factors put in place by the organization.

Having understood and assessed the likelihood, the effect of the risk is analyzed (refer to the illustration in the table that follows).

Quantitative/ Qualitative	Effect	Perspective	Area of the effect	Time frame
Quantitative	Direct cost of treatment, compensation and lost time by employee	Financial – direct cost Operational – production	Internal External	Short
	Closure or suspension of mining activities by regulator pending investigation	Financial – revenue lost Operational – production Regulatory – infringements	Internal	Short/ Medium
	Penalties and restrictions imposed by regulators	Financial – direct cost Operational – restricted activity Regulatory – infringements	Internal	Short/ Medium
Qualitative	Effect on reputation as an organization to key stakeholders – investors, communities, employees, regulators – and social licence to operate	Strategic – ability to compete/ obtain licences Reputational – poor record Regulatory – track record	Internal	Short/ Medium/ Long
	Effect on ability to retain existing and obtain new mining rights and licence	Strategic – growth & continuity Regulatory – track record endorsements	Internal	Medium/ Long

The magnitude of the effects will have to be compared to various thresholds to determine the importance of such effect. These could be a:

- Monetary amount – current year financial effect and future years (e.g., \$10 million).
- Operational effect – extent of production volumes lost or interrupted (e.g., >5% production).
- Strategic – extent to which future mining rights and licence could be jeopardized (regulatory).
- Regulatory – point at which endorsements will result in serious consequences (regulatory).
- Reputational – effect of reputation on investors’ view of business profile, employees and business partner concerns and community effect (judgement – sensitivity analysis).

### Prioritization of material matters

33. Once the population of material matters is identified, the matters should be prioritized, based on their importance, by senior management and those charged with governance. Senior management and those charged with governance should be satisfied that the filters and processes in place to identify material matters for <IR> purposes will allow all material matters to be brought to their attention. Those matters with the greatest effect or potential effect over time on the organization’s ability to create value are considered the most important.

34. Prioritization assists with focusing on those matters to which the most importance is to be attached in the manner in which they are reported. For example, an integrated report may include a more prominent or detailed discussion of matters with a higher prioritization, or collectively discuss certain matters with a lower priority. If the population of material matters is quite large, the prioritization assists in revisiting the materiality threshold and the process of assessing importance to determine whether it may be appropriate to narrow the population further. In prioritizing the population, the organization challenges itself as to which of the matters those charged with governance devote their attention relating to the organization’s ability to create value over time.

## Disclosure

35. Material matters require disclosure (see Appendix 2 for examples of disclosures of material matters). The nature and extent of disclosure in the integrated report depends, to a large extent, on the nature of the matter and will also be influenced by application of all the Guiding Principles, particularly the concepts of conciseness and reliability. The matters to which those charged with governance devote their attention should be presented clearly and unambiguously in the integrated report. In addition to the disclosure of material matters in the integrated report, the process employed by the organization to identify material matters for <IR> purposes should also be disclosed. See Appendix 3 for examples of disclosures of the <IR> materiality determination process.

## Disclosure of material matters in the integrated report

36. Judgement is applied in determining the appropriate disclosure of material matters in the integrated report. Taking the nature of the matter into consideration, the organization considers providing:

- Key information about the matter, such as the following:
  - an explanation of the matter
  - an explanation of how the matter affects/affected the organization's strategy, its business model or the capitals
  - an explanation of any interaction, inter-relatedness and dependencies associated with the matter (providing an understanding of causes and effects based on the identification of relationships and behaviours within a model, context or scenario)
  - the organization's view on the matter, including potential outcomes or effects
  - description of the planned response to the matter or how the matter is currently being managed by the organization (including descriptions of mitigating actions in response to the organization's risk assessment)
  - metrics or an indication of how effective the organization has been at capitalizing on opportunities or managing its risks
  - explanation or indication of the extent of the organization's control over the matter
  - comparative data for prior periods
  - applicable key performance indicators<sup>12</sup> (KPIs)
  - targets and expectations
  - quantitative and qualitative disclosures
- If there is uncertainty surrounding a matter, disclosures about the uncertainty, such as the following:
  - an explanation of the uncertainty
  - the range of possible outcomes and associated assumptions and probabilities
  - the certainty range or confidence interval associated with the information provided
- If key information about the matter is considered indeterminable, that fact and the reason for it.

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<sup>12</sup> For guidance with regard to KPIs see, for example:

- KPIs for ESG: A Guideline for the Incorporation of ESG into Financial Analysis and Corporate Valuation (2010), Society of Investment Professionals in Germany in conjunction with European Federation of Financial Analysts Societies, at [http://www.effas-esg.com/?page\\_id=206](http://www.effas-esg.com/?page_id=206)
- The Sustainability Reporting Framework (various), Global Reporting Initiative, at <https://www.globalreporting.org/reporting/reporting-framework-overview/Pages/default.aspx>
- ESG Reporting Guide for Australian Companies: Building The Foundation For Meaningful Reporting (2011), Financial Services Council and the Australian Council of Superannuation Investors, at [http://www.fsc.org.au/downloads/file/ResearchReportsFile/2011\\_0725\\_ESGREPORTINGGUIDEPRINandPOSTPROOFVersion.pdf](http://www.fsc.org.au/downloads/file/ResearchReportsFile/2011_0725_ESGREPORTINGGUIDEPRINandPOSTPROOFVersion.pdf)
- Concept Paper on WICI KPI in Business Reporting ver. 1 (2010), World Intellectual Capital Initiative and various industry-specific KPIs based on the idea of the WICI Concept Paper at <http://www.wici-global.com/kpis>
- Reporting Intangibles (2005), Athena Alliance, at <http://www.athenaalliance.org/pdf/ReportingIntangibles.pdf>

The above listing provides illustrative matters to consider and is not to be viewed as an all-inclusive listing or a template of what to report with respect to each material matter. (See Appendix 2 for examples of disclosures of material matters in <IR>.)

37. Depending on the nature of a matter, it may be appropriate to present it on its own in the integrated report or in conjunction with the different Content Elements; however, in either case, it is important to provide the right level of connectivity and context in the report with respect to the Content Elements. For example, if a material regulatory change has occurred during the year, the organization might include the following information with respect to each of the Content Elements:

- Organizational overview and operating context (which includes competitive landscape) – a description of the facts surrounding the change and identification of the organization’s principal activities, markets or products and services affected by the change.
- Governance – a description of:
  - what actions those charged with governance took to influence the strategic direction of the organization and its approach to risk management as a result of the change
  - any effect on executive remuneration resulting from over/underperformance against targets resulting from the change
  - any adjustments to future remuneration policies resulting from the change.
- Opportunities and risks – a description of the full nature of the underlying opportunities and risks associated with the regulatory change.
- Strategy and resource allocation – a description of how the organization has responded to the change in its chosen strategic objectives and strategies, and any changes to risk management arrangements related to the key affected capitals.
- Business model – a description of changes made to the business model as a result of the change
- Performance and outcomes – a description of how performance against identified strategies and targets was affected by the change, and the key outcomes of the change in terms of how it has changed the effects of the organization’s activities on the capitals.
- Future outlook – a description of the future outlook for the organization as a result of the change, including the anticipated regulatory environment that the organization is likely to face in the future and how is it currently equipped to respond.

### Conciseness

38. Disclosures about material matters in an integrated report should include concise information that provides sufficient context to make the disclosures understandable and should avoid information that is redundant in nature. In achieving conciseness, key information about the material matter should not be excluded; however, additional detailed information about the matter can be provided separately on the organization’s website or in other forms of communication, with links provided to such information. In preparing an integrated report, the organization seeks a balance between complete, concise and comparable information.

### Disclosure of the <IR> materiality determination process

39. The integrated report should disclose the <IR> materiality determination process employed by the organization. The objective of this disclosure is to enable providers of financial capital to understand the process employed by the organization (including how decisions were made to include or exclude various matters), and thereby enable them to make an informed assessment of the methodology used. At a minimum, the integrated report should:

- 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>.

(See Appendix 3 for examples of disclosures of the <IR> materiality determination process.)

## Potential constraints or challenges in the current environment

40. Potential constraints associated with the <IR> materiality determination process and disclosure of material matters in an integrated report are discussed below:

- Concerns about potential conflict of interest for report preparers (transparency vs. information that deters report users):  
Depending on an organization's circumstances, it is possible that a conflict of interest may arise for report preparers attempting to balance transparent reporting with information that may deter investors. One of the primary goals of <IR> is to shift the primary focus of providers of financial capital from the short term to the long term to allow organizations to address short and medium term challenges without penalty. Taking this into consideration, it is presumed (especially over time as <IR> becomes widely adopted) that where an organization can demonstrate that it will continue to create value over the long term (despite short or medium term challenges) that transparent reporting will be well received by the providers of financial capital.
- Concerns about disclosure of competitively sensitive information:  
Material matters relate to matters that affect the organization's strategy, its business model, or one or more of the capitals and may be viewed as competitively sensitive. One perceived constraint is the potential for loss of competitive advantage through the disclosure of commercially-sensitive information. It is not expected that an organization disclose information in an integrated report that would significantly harm its competitive advantage, and the banner of commercial sensitivity is not to be used inappropriately to avoid disclosure. If material information is not disclosed because of perceived competitive harm, this fact and the reasons for it are to be noted in the integrated report.  
Many corporations already hold analyst calls in which they discuss strategic objectives and strategies. Similar to those calls, the organization considers how to describe the essence of the strategies that are critical to the organization without identifying specific information that might cause a loss in competitive advantage.  
For example, it is often the case that information about strategies is already known to the market, and therefore available to competitors, and that the true competitive advantage in such cases lies in how those strategies are executed (e.g., the efficiency and effectiveness of the processes and practices used) rather than in the strategies themselves.  
Accordingly, the organization considers what actions a competitor could actually take with information in an integrated report and how it would affect the organization in considering whether such information would truly harm competitive advantage, and balance this against the legitimate information needs of intended report users.
- Concerns about disclosure of future-oriented information:  
Material matters include matters that affect the current business reporting cycle as well as future periods. Organizations may be reluctant to disclose matters related to future periods due to potential legal liability that may result if such matters do not materialize as originally anticipated. It is not intended that organizations be required to disclose forecasts or projected results, they should simply disclose the material raw information that would enable investors and other stakeholders to run models or make their own predictions about the future value creation potential of the organization.
- Concerns about the assurability of the materiality determination process:  
Application of the materiality determination process and decisions made regarding what to include in, and what to exclude from, the integrated report require a significant amount of judgement. The process and, in particular, assessing the completeness of an integrated report, may prove challenging from an assurance perspective. Such assurability concerns could be viewed as a potential constraint.
- Achieving a balance between internal and external perspectives:  
There is a perception that balancing the views of what is material from the organization's perspective with the views of what is material from external stakeholders' perspectives may prove challenging. <IR> aims to bring these two perspectives closer together by focusing on the ability of the organization to create value over time as the guide for what is considered material. As stakeholder actions will ultimately affect an

organization's ability to create value over time, it is not possible to ignore external stakeholder perspectives. As a result, external stakeholder perspectives will have to be considered and assigned an appropriate level of importance as an organization considers what is considered material with regard to its ability to create value over time.

- Understanding how matters outside of an organization's control may be considered material:  
The definition of materiality focuses on the organization's ability to create value. Factors both within and outside of an organization's control can affect the organization's ability to create value – it is thus essential that matters outside of an organization's control be considered in the determination of material matters.
- Having appropriate information structures in place to be able to apply materiality considerations:  
Initially, organizations may not have the appropriate processes and systems in place to identify, analyze and disclose material matters. Over time, organizations will have to develop or implement appropriate systems to support their materiality processes. Leveraging existing Enterprise Risk Management (ERM) systems may prove particularly helpful to organizations that have such systems in place. While the exact nature of the required processes and information systems will vary depending on the particular organization (e.g., sector, scale, location) and its material opportunities and risks, the following core information structures would need to be in place:
  - Processes and systems for identifying and assessing opportunities and risks and, in particular, identifying opportunities and emerging risks (risk inventory)
  - Processes and systems for capturing information and measurements
  - Processes and systems for reviewing and responding
  - Processes for stakeholder engagement.
- Practical difficulties associated with providing complete and accurate disclosure of material matters:  
There may be situations where it is difficult or impossible or very costly to obtain the required information from certain locations within an organization in order to quantify or present complete disclosure of material matters. The most essential consideration with regard to disclosure of material matters in an integrated report is that all material matters be disclosed. The extent of disclosure or quantification of the matter is a secondary consideration that will require judgement and depend on the existing facts and circumstances.
- Understanding whether local or global matters should be considered material:  
Both local and global matters have the ability to affect the organization's ability to create value, thus, to the extent local or global matters have an important effect on an organization's ability to create value, they should be considered material.

## Appendices

### Appendix 1 – Guidance: stakeholder engagement

For further guidance with regard to stakeholder engagement, see, for example:

#### **AA1000 Stakeholder Engagement Standard (2011)**

##### Accountability

<http://www.accountability.org/standards/aa1000ses/index.html>

The AA1000 Stakeholder Engagement Standard provides a principles-based, open-source framework for quality stakeholder engagement and supports the AA1000APS Principle of Inclusivity. It can be used as a “stand-alone” standard, or as a mechanism to achieve the stakeholder requirements of other standards.

#### **Stakeholder Engagement: A Good Practice Handbook for Companies Doing Business in Emerging Markets (2007)**

##### International Finance Corporation

[http://www1.ifc.org/wps/wcm/connect/938f1a0048855805beacfe6a6515bb18/IFC\\_StakeholderEngagement.pdf?MOD=AJPERES](http://www1.ifc.org/wps/wcm/connect/938f1a0048855805beacfe6a6515bb18/IFC_StakeholderEngagement.pdf?MOD=AJPERES)

#### **The Stakeholder Engagement Manual: The Practitioner’s Handbook on Stakeholder Engagement (Vol. 2) (2005)**

##### AccountAbility, the United Nations Environment Programme, and Stakeholder Research Associates

<http://www.unep.fr/shared/publications/pdf/WEBx0115xPA-SEhandbookEN.pdf>

The manual provides a step-by-step guide for the organization on how to start and improve its engagement with stakeholders, based on a selection of core principles and focusing on continual improvement.



## Appendix 2 – Examples of disclosures of material matters

The disclosure examples referenced in this Background Paper for <IR> are intended to give the reader a sense of how organizations developing integrated reports are presenting material items. However, the examples cited are from reports prepared prior to the development of the Prototype Framework and, accordingly, do not necessarily fully address the <IR> concepts included in the Prototype Framework. Therefore, these examples are not intended to reflect best practice; rather they represent illustrative examples of current practice in the journey towards <IR>. As described in the Background Paper for <IR>, the determination of what is material for inclusion in the integrated report will differ by industry and by organization. In viewing the cited examples, readers should consider the following:

- Is key information provided about the material matters to understand the implications on the organization and others?
- Is there a sufficient level of connectivity between the various Content Elements?
- Are the disclosures sufficiently concise?

### Example 2.1

#### **The Truworths International Limited Integrated Annual Report 2011**

(for the year ended 30 June 2011, p. 13-21, [www.truworths.co.za](http://www.truworths.co.za)) These pages provide an example of material matters that have been presented in a clear and concise manner. The organization lists its eight material matters and then presents each in greater detail in conjunction with various Content Elements. Each material matter is linked to the applicable strategic objective, associated challenges and risks and risk mitigating strategies, relevant performance metrics (for both the current and prior year) and future strategic objectives.

### Example 2.2

#### **The Tsogo Sun Integrated Annual Report 2012**

(for the year ended 31 March 2012, p. 18-23, [www.tsogosun.com](http://www.tsogosun.com)) These pages illustrate how material matters can be presented in conjunction with different Content Elements to provide linkage and context for the material issues in relation to the other Content Elements. The organization presents the following matters in conjunction with each other: material risks, potential effects of those risks, related risk mitigation efforts, associated strategic priorities, related KPIs and references to more detailed information.

### Example 2.3

#### **The Foskor Integrated Annual Report 2012**

(for the year ended 31 March 2012, p. 23-27, [www.foskor.co.za](http://www.foskor.co.za)) These pages illustrate how material matters can be presented in conjunction with different Content Elements to provide linkage and context for the material issues. The organization presents the following matters in conjunction with each other: material matters, associated opportunities, risk mitigation and control measures, strategic response, KPIs and performance against KPIs.

### Example 2.4

#### **The Altron Integrated Annual Report 2012**

(for the year ended 29 February 2012, p. 14-16, [www.altron.co.za](http://www.altron.co.za)) These pages illustrate how material matters can be presented in conjunction with different Content Elements to provide linkage and context for the material issues in relation to the other Content Elements. The organization's material risks and opportunities are presented in conjunction with related performance and future strategies.

### Example 2.5

#### **The Rio Tinto Annual Report 2011**

(for the year ended 31 December 2011, p. 14-15, [www.riotinto.com](http://www.riotinto.com)) These pages illustrate how the various Content Elements, can be presented in conjunction with each other. The organization presents its strategy in conjunction with the related performance against that strategy.

## Appendix 3 – Examples of disclosures of the <IR> materiality determination process

The disclosure examples referenced in this Background Paper for <IR> are intended to give the reader a sense of how organizations developing integrated reports are disclosing the materiality determination process. However, the examples cited are from reports prepared prior to the development of the Prototype Framework and, accordingly, do not necessarily fully address the <IR> concepts included in the Prototype Framework. Therefore, these examples are not intended to reflect best practice; rather they represent illustrative examples of current practice in the journey towards <IR>. In viewing the cited examples, readers should consider the following:

- Does the description of the materiality determination process provide a sufficient understanding of the process employed by the organization to determine which matters it considered material for purposes of inclusion in an integrated report, including how decisions were made to include or exclude various matters?
- Does it provide sufficient information to make an informed assessment about the robustness of the process?
- Does it identify key personnel involved in identification and prioritization of material matters?
- Does it identify the governance body with oversight responsibilities for <IR>?

### Example 3.1

#### **The Altron Integrated Annual Report 2012**

(for the year ended 29 February 2012, p. 6-9, [www.altron.co.za](http://www.altron.co.za)) These pages provide a diagrammatic summary of the organization's materiality determination process and then explain the process in greater detail thereafter. The process indicates what has been considered, which stakeholders have been engaged, how the stakeholders have been engaged and how each of the elements considered feed into the organization's overall strategy.

### Example 3.2

#### **The Nedbank Group Integrated Report 2011**

(for the year ended 31 December 2011, p. 4, [www.nedbankgroup.co.za](http://www.nedbankgroup.co.za)) This page provides a high-level description of the process used to define material matters (including the approval process).

### Example 3.3

#### **The AFGRI Integrated Annual Report 2012**

(for the year ended 30 June 2012, p. 1, [www.afgri.co.za](http://www.afgri.co.za)) This page discloses a summary of the methodology used for determining materiality.

### Example 3.4

#### **The Aveng Group Integrated Report 2012**

(for the year ended 30 June 2012, p. 21, [www.aveng.co.za](http://www.aveng.co.za)) This page indicates the factors considered in determining material matters.

This appendix lists the various definitions considered in arriving at the definition of materiality for <IR> purposes:

## Appendix 4 – Materiality definitions considered

“Materiality is determining the relevance and significance of an issue to an organisation and its stakeholders. A material issue is an issue that will influence the decisions, actions and performance of an organisation or its stakeholders.” (AccountAbility 2008)

“Material issues are those things that could make a major difference to an organisation’s performance. Material information provides the basis for stakeholders and management to make sound judgements about the things that matter to them, and take actions that influence the organisation’s performance.” (AccountAbility 2006)

“Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of an individual entity’s financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.” (IASB 2010)

“Information is material if omitting it or misstating it could influence decisions that users make on the basis of the financial information of a specific reporting entity. In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude or both of the items to which the information relates in the context of an individual entity’s financial report. Consequently, the Board cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.” (FASB 2010)

“Principle: The report should cover topics and Indicators that:

- reflect the organization’s significant economic, environmental, and social impacts or that
- substantively influence the assessments and decisions of stakeholders.” (GRI 2012)

“Definition: The information in a report should cover topics and Indicators that:

- reflect the organization’s significant economic, environmental, and social impacts or that
- would substantively influence the assessments and decisions of stakeholders.” (GRI 2011)

“Information is considered to be material if, by its inclusion or exclusion, it can be seen to influence any decisions or actions taken by users of it. A material discrepancy is an error (for example, from an oversight, omission or miscalculation) that results in a reported quantity or statement being significantly different to the true value or meaning.” (WBCSD and WRI 2001)

Materiality concerns the significance of an item to users of a registrant’s financial statements. A matter is “material” if there is a substantial likelihood that a reasonable person would consider it important. (SEC, 1999)

A fact is material if there is “a substantial likelihood that the...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).

## Appendix 5 – References

### **AA1000 Accountability Principles Standard**

(2008)\*\* AccountAbility

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### **A review and integration of empirical research on materiality: two decades later**

(2005), Messier, W., Martinov-Bennie, N. and Eilifsen, A.

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### **Consultation Paper - Considerations of materiality in financial reporting**

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### **On Materiality and Sustainability: The Value of Disclosure in the Capital Markets**

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## Appendix 5 – References (continued)

### **Redefining Materiality - Practice and public policy for effective corporate reporting**

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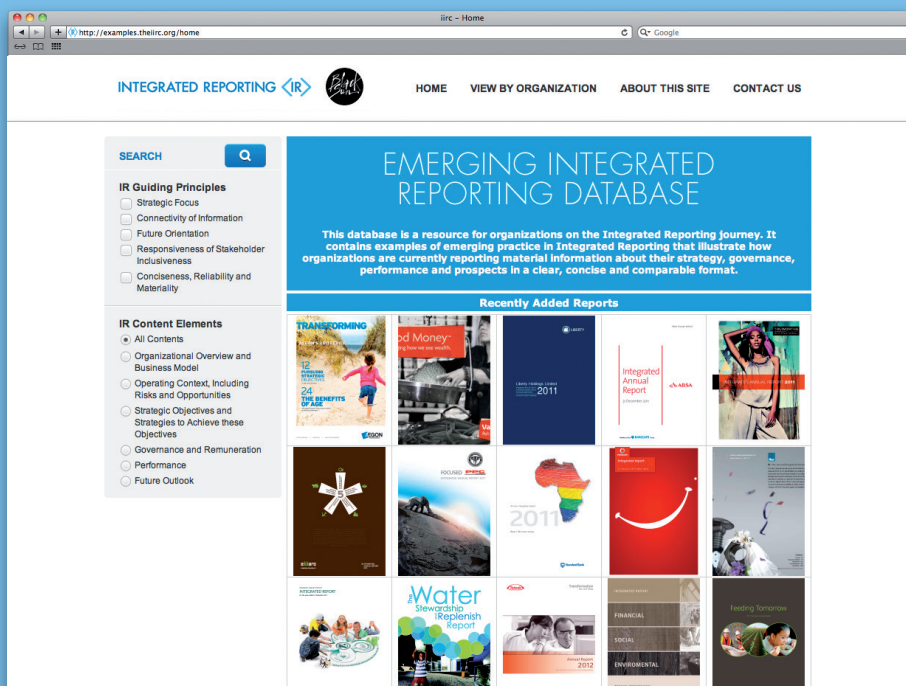
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## VISIT THE EMERGING INTEGRATED REPORTING DATABASE



<http://examples.theiirc.org/>