Integrated Reporting Update

The concept of ‘materiality’ in Integrated Reporting

This IR Update comprises the following:
- Definition of materiality for IR
- Importance of materiality for IR
- How to determine materiality
- A summary of the process to apply when determining and disclosing material matters
- Challenges in applying the concept of materiality
Integrated Reporting Update

This document summarises the Materiality background paper (paper) released by the International Integrated Reporting Council (IIRC) in March 2013. The IIRC is considering this paper in the development of the International Integrated Reporting (IR) Framework Consultation Draft.

Note: For a full copy of this paper, please refer to the IIRC’s website www.theiirc.org/resources-2/framework-development/background-papers/

Summary of the IIRC’s paper on materiality

Definition of materiality for IR:

- The IIRC’s paper states that for the purpose of IR, a matter is material if it is of such relevance and importance that it could substantively influence the assessment of providers of financial capital with regard to the organisation’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 organisation’s strategy, its business model, or one or more of the capitals (e.g. financial, manufactured, human, intellectual, natural, social, relationship) it uses or affects.

The importance of materiality for IR:

- The IIRC’s paper explains that materiality plays a crucial role in determining the matters to be included in an IR and ensuring conciseness thereof.

How to determine materiality:

- The paper states that materiality assessments should be performed at least annually, but ideally should be embedded as a continuous process that is performed as part of everyday decision-making by senior management and those charged with the governance of the organisation.
- The paper explains that material matters could include financial and non-financial matters, positive and negative matters, including risks, opportunities, favourable and unfavourable results.
- The paper describes three key concepts in determining whether a matter is material to the IR, namely relevance, importance and prioritisation.

1. Identify relevant matters to include in the IR, considering
   - Value drivers
   - Stakeholder issues
   - External factors
   - Internal factors
   - Current performance
   - Ability to create value

2. Assess the importance of the matters, based on
   - Magnitude of effect
   - Likelihood of occurrence

3. Prioritise material matters
   - Prioritise material matters based on importance

4. Disclose
   - Materiality process
   - People involved in the process
   - Governance body and oversight for IR
   - Description of material matters, performance and targets
   - Level of control over matters
   - Implications for the organisation
   - Uncertainties
1. Identify relevant matters to include in the IR
The relevance of matters for inclusion in the IR should be based on whether the matter has a past, present or future effect on the organisation’s ability to create value over time. Management should consider matters to be relevant when
- The matter affects the value drivers that ensure an organisation’s competitive advantage;
- The matter has been identified through engagement with stakeholders such as investors, suppliers, customers, communities or government;
- The matter is a result of external factors such as economic, technological, legislative, societal and environmental changes or challenges, as well as risks identified through the risk management process;
- The matter is a result of internal factors such as the ability to respond to changing conditions, innovate and leverage relationships;
- The matter will affect the organisation’s performance in the current reporting cycle;
- The matter will affect the organisation’s strategy, business model or the capitals and thus affects the organisation’s ability to create value over time.

When determining the magnitude of effect, consideration should be given to the following:
- The quantitative importance of matters that impact on financial measures (such as gross margin, gearing, liquidity ratios, credit risk, or efficiency) as well as non-financial measures (such as market share, yields and production volume);
- The qualitative importance of matters such as those that increase regulatory risk (such as infringement of civil or criminal regulations and resultant penalties), reputational risk (such as product recalls, health risks or failure to pay suppliers) and strategic risk (such as the ability to sustain safety performance levels, growing market share leadership, margin growth or retention, R&D and product pipeline development);
- The area of impact being either internal (affecting for example, continuity of operations) or external (for example, how the impacts on external stakeholders or the environment in turn impacts the organisation’s reputation or the availability, affordability and quality of capitals on which the organisation relies); and
- The time frame of the effect, being either short term (such as a safety incident resulting in the suspension of operations or penalties), medium term (such as licence renewal issues), or long term (such as the lack of innovation or investment). Whether the term is considered short, medium or long term may differ per industry, an organisation’s investment cycle, strategies and stakeholder expectations.

2. Assess the importance of the matters
The decision to include matters in the IR should be based on an assessment of the importance of each matter, which is a function of the magnitude of the effect (on a gross basis) of the matter and the likelihood of its occurrence. The paper explains that if it is determined that the likelihood of occurrence and the potential magnitude of the effect of a matter is of such importance that the matter has the potential to substantively influence assessments about the organisation’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.

3. Prioritise material matters
The paper states that senior management and those charged with governance should be satisfied that filters and processes followed allow all material matters to be brought to their attention. The disclosure of matters which are identified as more important than others should be more prominent and detailed.

Refer to Appendix 3 of the IIRC’s paper for examples of how companies in practice are disclosing their materiality determination process.
4. Disclose

The paper notes the following aspects relating to materiality that should be disclosed in the IR:
- Description of the process followed to identify, assess and prioritise matters for inclusion in the IR;
- Key personnel involved in the process and the governance body responsible for the oversight of IR;
- Description of material matters;
- Implications for the organisation in terms of its strategy, the business model, performance, outcomes and other stakeholders;
- Organisation’s level of control over the matters and planned responses;
- An indication of how well the organisation is managing the associated risks and/or capitalising the opportunities;
- Respective KPI’s with actual (current and historical) as well as target performance data
- Information about any uncertainty surrounding the matter.

Refer to Appendix 2 of the IIRC’s paper for examples of how companies in practice are disclosing their material matters.
Challenges in applying the concept of materiality

The paper describes the following potential challenges in determining and disclosing materiality in IR:

<table>
<thead>
<tr>
<th>#</th>
<th>Challenges and concerns</th>
<th>Possible response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Investors may be deterred if both positive and negative matters are disclosed in an attempt to achieve balanced and transparent reporting.</td>
<td>The paper suggests that the purpose of IR is to move the investors' focus from the short to the long term and that it is presumed that transparent reporting will be well received by investors in assessing the ability of an organisation to create value over time, despite challenges in the short to medium term.</td>
</tr>
<tr>
<td>2</td>
<td>There is a potential loss of competitive advantage when sensitive information is disclosed.</td>
<td>The paper suggests that strategies are often already known to the market and the true competitive advantage lies in the execution of the strategies.</td>
</tr>
<tr>
<td>3</td>
<td>There may be potential liability if matters do not materialise as previously disclosed in the future-orientated information.</td>
<td>The paper notes that it is not intended that organisations disclose forecasts or projected results, rather that material information be disclosed that would enable stakeholders to make their own predictions about the future value creation potential of the organisation.</td>
</tr>
<tr>
<td>4</td>
<td>It may be challenging to assure the completeness of material matters disclosed in the IR.</td>
<td>The paper notes that an assessment of the materiality determination process and an assessment of the completeness of an integrated report, may prove challenging from an assurance perspective. Such assurability concerns could be viewed as a potential constraint.</td>
</tr>
<tr>
<td>5</td>
<td>It may be challenging to disclose a balanced view of the issues perceived to be material by both the organisation and external stakeholders.</td>
<td>The paper notes that external stakeholder perspectives will have to be considered and assigned an appropriate level of importance as an organisation determines what is considered material with regard to its ability to create value over time.</td>
</tr>
<tr>
<td>6</td>
<td>Matters disclosed may be outside the organisation’s control.</td>
<td>The paper notes that matters outside of an organisation's control must be considered during the materiality determination process as factors both within and outside of an organisation's control can affect its ability to create value.</td>
</tr>
<tr>
<td>7</td>
<td>Processes and systems to identify, analyse and disclose material issues may be lacking.</td>
<td>The paper notes that processes and systems should be developed over time to identify and assess opportunities and risks, to capture information and measurements and respond to stakeholder issues.</td>
</tr>
<tr>
<td>8</td>
<td>The quantification of complete and accurate information may be challenging due to limited availability and cost implications.</td>
<td>The paper emphasised that all material matters must be disclosed. The extent of disclosure or quantification of the matter is a secondary consideration that will require judgment and depend on the existing facts and circumstances.</td>
</tr>
<tr>
<td>9</td>
<td>The prioritisation of disclosure of local or global matters may be unclear.</td>
<td>The paper notes that as both local and global matters have an important effect on an organisation’s ability to create value, they should both be considered for disclosure.</td>
</tr>
</tbody>
</table>
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organisation and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organisation, please visit ey.com.

© 2013 EYGM Limited.
All Rights Reserved.

Creative Services Job Number:
130429

In line with EY’s commitment to minimise its impact on the environment, this document has been printed on paper with a high recycled content.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com

Contacts

Key contacts that can assist you in your IR journey

Jeremy Grist
Director
Climate Change & Sustainability Services
Tel: +27 (11) 772 3029
email: jeremy.grist@za.ey.com

Kelly Gilman
Senior Manager
Climate Change & Sustainability Services
Tel: +27 (21) 443 1473
email: kelly.gilman@za.ey.com