GRI

The GRI Perspective

The materiality madness: why definitions matter

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The IOSCO chair Ashley Alder recently stated that the "*ISSB climate standard won't ignore impact*".This relatively innocent sounding sentence created confusion on whether this meant a turnaround in the positioning of the IFRS Foundation on the exclusive focus on financial materiality for their sustainability reporting. Will the International Sustainability Standards Board (ISSB) also move to 'double materiality' - just like the EU - and focus not only on financial risks and opportunities for the company but also on the impact of the company's activities on the economy, environment and people?

At the moment it seems like a tempest in a teapot as it is highly unlikely that the ISSB has the ambition to arrive at true impact reporting. The existing disclosure guidelines the ISSB draws upon - TCFD, Value Reporting Foundation (which includes SASB) and CDSB - *all have an exclusive focus on financial materiality for an investor-based audience*. **The only credible partner to fill in the 'impact' angle in the corporate reporting landscape - without having to reinvent the wheel - is GRI.**

However, Mr. Alders' statement did underline that we need clarity on what impact truly means and how that translates into the concept of materiality in relation to sustainability reporting.

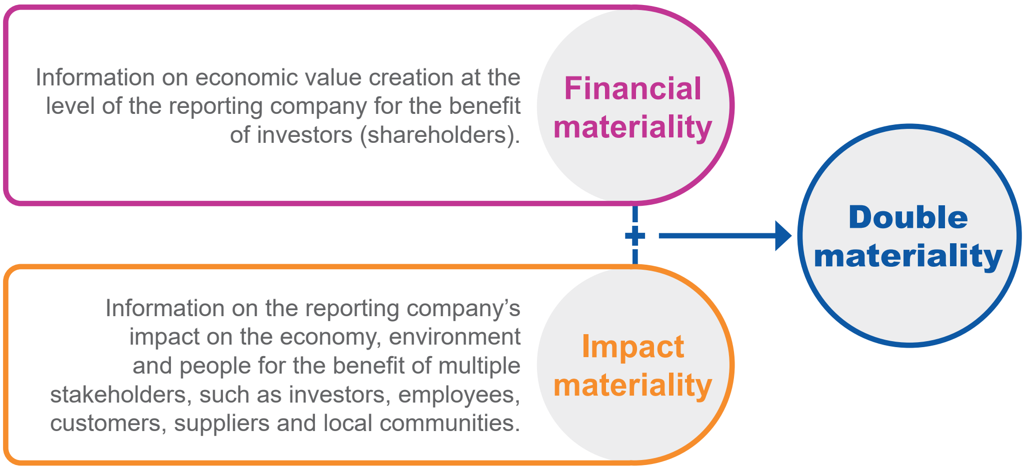
Back to basics

Materiality is a key concept in the world of reporting and plays a part both in the preparation of the disclosures and their verification by an auditor. Materiality is used to 'filter in' the information that is or should be relevant to users. Particular information is considered 'material' - or relevant - if it could influence the decision-making of stakeholders in respect of the reporting company.

This brief description outlines that materiality is not a clear-cut concept and is subject to interpretation. What matters is not just what is meant by information but, crucially, who the stakeholders are. Are these only financial decision-makers such as investors and financiers? Or do they also include other parties such as employees, suppliers, customers and communities; that is, the *socio-economic environment*? The next question is how influence must be interpreted. Is this purely financial, in terms of costs or compliance - in other words, value creation for the reporting company itself? Or must it be viewed in terms of impact on the economy, the environment and people? It is through defining influence that the confusion around the concept of materiality starts.

The confusion around materiality

To make it clear from the start, there are two main directions of thinking about materiality, which together make up the concept of ‘double materiality’:



Recently we have seen a wild growth of terms being introduced in addition to the more familiar concepts of financial materiality and impact materiality such as: ‘dynamic materiality’, ‘*nested materiality*’, ‘extended materiality’ and ‘*core materiality*’. They are meant to strike a bridge between financial and impact materiality, but all it does is adding to the **materiality madness**, making the idea behind the concept of materiality unnecessarily complicated.

Of those concepts, *dynamic materiality* is heard most often. It is based on the primacy of ‘financial materiality’ but has been extended by the notion of ‘pre-financial information’. The point of departure is that some sustainability issues have no direct monetary impact on the company’s financial value creation in the here and now, but may do so in the medium or long term.

Blurring the boundaries between financial and impact materiality, by stating that some information is dynamic rather than static, complicates the way substance should be given to sustainability disclosures. **The concept of dynamic materiality is basically a postponement of double materiality** whereby companies should report on matters that influence enterprise value (financial materiality) and matters that affect the economy, environment, and people (impact materiality).

The reality is that the **impacts of an organization are or will become financially material** over time. Without understanding these impacts, it won’t be possible to get a complete overview of financially material issues affecting the company, an exercise that GRI supports. Besides, **impact reporting is also highly relevant in its own right as a public interest activity for multiple stakeholders**. The impacts of a company matter and must be reported even if the company or its investors do not consider them to be financially material, either now or in the future.

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.

Materiality and the current landscape

Two sustainability reporting developments are happening that take a different approach on materiality.

1. The European Sustainability Reporting Standards (ESRS) being created by the EU will be based on **double materiality**, for a multi stakeholder audience (which includes investors). GRI and the European Financial Reporting Advisory Group (EFRAG) are leading its co-construction efforts.

2. The standards for the disclosure of sustainability-related financial information are being drafted by the IFRS Foundation - with which the newly established ISSB is charged with - and will be based on **financial materiality** for an investor audience only.

In our view, the approaches of the IFRS and the EU are not competing but complementary forces. Different standards have different purposes for different audiences. Standards with a sole purpose to inform investors are built on a different concept from impact standards that inform a broader group of stakeholders. **The GRI Standards are the only global standards with an exclusive focus on impact reporting for a multi-stakeholder audience - making it an essential factor in the shaping of a reporting structure based on double materiality**.

As such, GRI has a key role in working with *EFRAG* and the *ISSB* to build this comprehensive global set of sustainability reporting standards - covering the information needs of investors as well as other stakeholders. It is in the interest of all stakeholders to create a corporate reporting system based on two pillars - **for financial and sustainability reporting - with a core set of common disclosures and each pillar on an equal footing**. The ultimate goal should be one set of standards globally underpinning both the financial and impact materiality perspective.

GRI is confident that, with goodwill and cooperation, we can quickly progress on both these fronts - delivering improved reporting that fulfils both applications of materiality, and meets the transparency needs of a multitude of stakeholders. Besides, *the concept of stakeholder capitalism not based on the concept of double materiality, just makes no sense at all*.

How we can help you

We encourage all organizations to use the GRI Standards, which are a free and public good. But, realizing that sustainability reporting is not easy, we provide a range of products and services to reporting organizations to help them produce high quality meaningful reports. Our **GRI Community** creates a peer-to-peer platform for sharing and learning. While through the **GRI Academy**, we offer a full suite training curriculum to enhance professional development on sustainability reporting.

Our ask

Our standards are free to use, but not free to develop. Creating and maintaining standards is time and resource intensive. To enable us to keep up the good work and stay on the leading edge of corporate sustainability reporting **we need your support!**

We are the international non-profit organization that reflects multi-stakeholder interests by developing and maintaining world-class sustainability reporting standards. If you would like to help us to remain so, we are happy to discuss other services you may require.

Get in touch →

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