INTEGRATED REPORTING <IR>

Materiality in <IR>

Guidance for the preparation of integrated reports

November 2015

International Federation of Accountants®

INTEGRATED REPORTING <IR>

About Integrated Reporting

Integrated Reporting enhances the way organizations think, plan and report the story of their business.

Organizations use Integrated Reporting to communicate a clear, concise, integrated story that explains how all of their resources create value. Integrated Reporting helps businesses to think holistically about their strategy and plans, make informed decisions and manage key risks to build investor and stakeholder confidence and improve future performance. The Integrated Reporting movement is shaped by a diverse coalition that includes business leaders and investors to drive a global evolution in corporate reporting.

As set out in the International <IR> Framework, an integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term. The Framework enables a business to bring these elements together through the concept of 'connectivity of information' to best tell an organization's value creation story.

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Executive summary

- This guidance supports the International <IR> Framework by explaining materiality, and the corresponding materiality determination process, in the context of Integrated Reporting. It also outlines expectations for materiality-related disclosures.
- The interpretation of materiality varies across report forms due to differences in audience, purpose and scope. In Integrated Reporting, a matter is material if it could substantively affect the organization's ability to create value in the short, medium or long term. The process of determining materiality is entity specific and based on industry and other factors, as well as multi-stakeholder perspectives.
- An emphasis on material matters should improve internal and external decision-making by limiting extraneous information and focusing disclosures on the core issues managed by the organization. This emphasis seeks to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.
- Preparing report content involves:
  - Establishing parameters for the materiality determination process
  - Filtering matters by identifying their relevance, evaluating their importance and prioritizing them based on their relative importance
  - Setting the reporting boundary
  - Determining disclosures.
- There is no rule prescribing the frequency or precise approach of the materiality determination process. Judgement should be used when deciding if, and to what extent, a detailed assessment is needed. At a minimum, organizations should revisit previously identified material matters during each reporting cycle to test their continued applicability.
- Embedding the materiality determination process into management processes can enhance the efficiency and effectiveness of decision-making and reporting. The extent to which integrated thinking underpins the materiality determination process, and is linked to board and management discussions, is also important.

When identifying relevant matters, consider topics or issues that:

- Could substantively affect value creation
- Link to strategy, governance, performance or prospects
- Are important to key stakeholders
- Form the basis of boardroom discussions
- May intensify or lead to opportunity loss if left unchecked.

When evaluating the importance of relevant matters, consider:

- Quantitative and qualitative effects
- The nature, area and time frame of effects
- Magnitude of effects and likelihood of occurrence.

When developing report content:

- Consult the guidance provided in Paragraph 4.50 of the Framework
- Ensure content meets the Completeness principle as described in Paragraphs 3.47-3.53 of the Framework
- Present information according to the matter's relative importance
- Demonstrate the connectivity of information per Paragraphs 3.6–3.9 of the Framework
- Consult Paragraphs 3.36-3.38 of the Framework for tips on conciseness.

When deciding on the depth and frequency of the materiality assessment, consider:

- The timing of the last comprehensive assessment
- The influence of external factors, including changes in economic conditions, resource availability or consumer tastes
- The influence of internal changes to leadership, strategy or business model
- Shifts in the needs, interests or profile of key stakeholders
- The emergence of new techniques for evaluating the magnitude of effects.

Exploring basic concepts

An integrated report should explain the factors that affect the organization's ability to create value over time. Focusing on core matters encourages meaningful and manageable reports that support decisions.

In this section

- Defining value
- Achieving focus
- Informing decisions
- Reconciling approaches

Defining value

The aim of Integrated Reporting is to communicate the full range of factors that affect an organization's ability to create value over time. With this in mind, the organization should understand how it defines and creates value before it can meaningfully define report content.

As shown in Figure 1, (page 8) value is created through the organization's business model, which, in turn, is shaped by the external environment, organizational mission and vision, strategy, risks and opportunities and interdependencies among key resources or capitals[1].

The concept of value is highly subjective. Some organizations express value solely in the context of financial returns. Others view the concept more broadly, perhaps in terms of fulfilling unmet market needs or advancing a particular mission. Recognizing that interpretations vary, the International <IR> Framework is non-prescriptive, but highlights that value created for the **organization** (enabling financial returns to providers of financial capital[2]) is linked to value created for **others**, including key stakeholders and society at large.

The exercise of internally defining and articulating the value creation process builds a collective understanding among management and those charged with governance. How the organization defines value – on its own terms, but reflecting the above considerations – is an important foundation for the materiality determination process.

A clear description of the organization's business model, which identifies inputs, business activities, outputs and outcomes, can help an organization map its approach to creating value.

Concepts in practice

- Nestlé believes that long term company prosperity and shareholder value hinge on creating societal value through **shared value commitments** in the areas of nutrition, water, rural development, environmental sustainability, human rights and compliance.
- In its **2014 Annual Report**, BASF describes the value that its various segments provide to the company and to others. In particular, the company evaluates its value chain and considers industry and regional perspectives to identify the value contributed to customers, the broader public and the natural environment.
- In its **2014 Integrated Report**, Entergy highlights its mission in the context of creating value for its four key stakeholder groups: owners, customers, employees and communities.

[1] The Framework identifies six forms of capital, namely financial, manufactured, intellectual, human, social and relationship, and natural.
[2] Includes existing and potential equity and debt holders, lenders and other creditors.

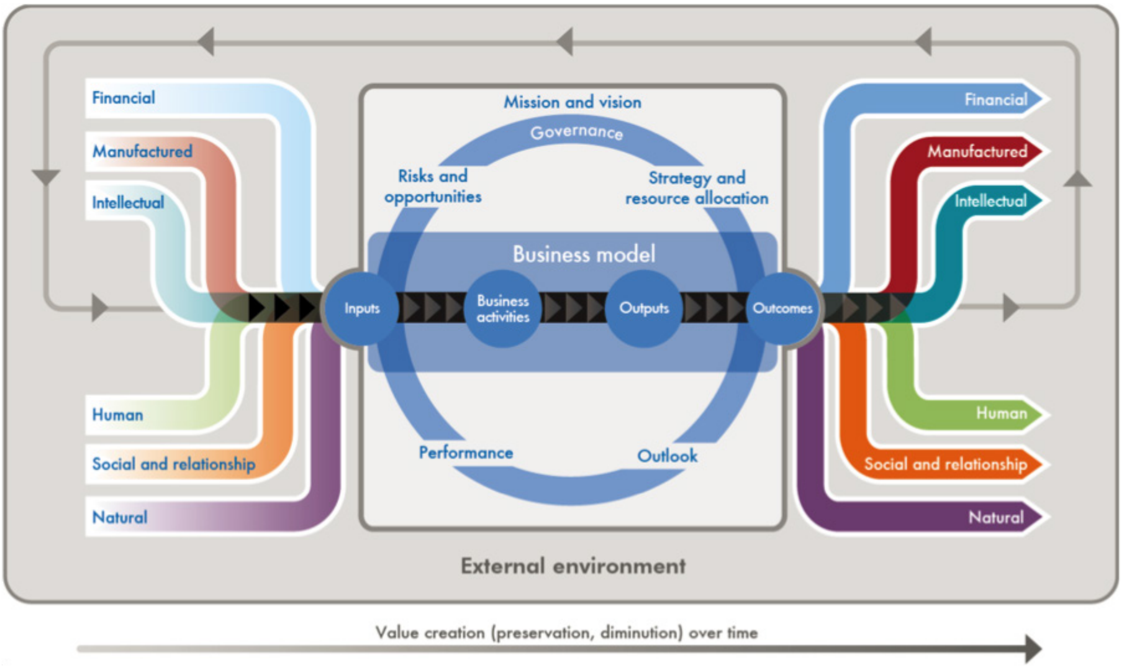


Figure 1. The value creation process (International <IR> Framework, 2013)

Achieving focus

In the context of Integrated Reporting, a matter is material if it could substantively affect the organization's ability to create value in the short, medium or long term. This emphasis on material matters improves decision-making by users of integrated reports by:

- Focusing attention on core issues managed by the organization
- Limiting extraneous information
- Supporting concise, digestible content.

Applying the definition of materiality is therefore as much an exercise in excluding immaterial items as it is identifying material matters. This benefits users of integrated reports and, as seen in the next section, preparers of integrated reports. The Framework's dual emphasis on materiality and conciseness seeks to avoid information overload and obfuscation of core issues. This leads to a sounder understanding of the organization, its value creation process and the management of that process.

To explain how organizations create value for themselves and for others, integrated reports often draw information from annual financial statements and accompanying narratives[3], governance disclosures and sustainability reports. **However, integrated reports are not mere summaries or restatements of disclosures found elsewhere; rather, they synthesize that information through the lens of value creation and demonstrate links to strategy, governance, performance and prospects.** Herein lies a critical distinction between integrated and combined reports.

To ensure integrated reports remain concise and focused on material matters, organizations can adopt a layered approach, whereby the integrated report is the overarching or umbrella document that draws on existing report strands to tell the value creation story. Cross-referencing to regulatory filings, voluntary reports and website content provides easy access to more detailed information. Some organizations choose to satisfy regulatory requirements, improve report functionality and manage disclosure burden through a single integrated report. Achieving a complete yet concise account of material matters is aided by links to, rather than repetition of, corporate policies, case studies and other content. Assurance engagements benefit from a clear indication of which information is uniquely part of the integrated report versus that referenced or sourced from other communications.

Informing decisions

The materiality determination process encourages boards and management to critically evaluate the trends, dependencies, risks and opportunities likely to shape the organization's trajectory. The process is entity-specific and predicated on internal and external conditions, industry factors and stakeholder perspectives, considerations that inform board and management discussions. The process is also inextricably linked to integrated thinking, the active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term[4].

Integrated thinking occurs when boards apply their collective mind to consider the connectivity between factors that influence value creation. This promotes alignment between what is reported externally and the reality of the organization's strategy, operations and internal decision-making.

Concepts in practice

- Discussing its **material issues**, The Crown Estate reinforces the link between determining materiality for reporting and managing the business: *"Identifying material issues enables us to focus our management time and attention where it really matters. It allows us to drive business growth which, at its core, is sustainable in the short, medium and long term."*
- At 36 pages, Itaú Unibanco's **2014 Integrated Report** introduces the bank's business model, strategy, resource dependencies and segment performance. The report links to related sections of the regulatory filings, including the Financial Statements and Consolidated Annual Report, which total roughly 500 pages.
- The **2014 Annual Report** of Enagás applies core Integrated Reporting principles. As the companwy's primary report, it includes financial and non-financial information and complies with legal requirements and voluntary reporting standards. The report features several Quick Response (QR) codes, which connect readers' portable devices to supplementary website content. This feature provides access to potentially interesting but non-essential information, leaving the decision to learn more in readers' hands.

[3] Including, for example, the Directors' Report, Management Commentary, Management's Discussion and Analysis or Operating and Financial Review.
[4] Integrated thinking is explored further in the IFAC publication, Creating Value with Integrated Thinking

Reconciling approaches

ma-te-ri-al Significant or relevant, especially to the extent of determining a cause or affecting a judgement.

Oxford Dictionary of British and World English

Some organizations find it challenging to navigate the range of materiality definitions across reporting regulations, standards and frameworks. It is important to understand the role of context and perspective as foundations for materiality definitions and assessments. As shown in Table 1, the frames of reference for applying the concept vary across report forms. **Attributes such as purpose, audience and scope vary, leading to different considerations in determining materiality.**

In the context of Integrated Reporting, the materiality determination process considers the following parameters:

Purpose. To explain to providers of financial capital how the organization creates value over time.

Audience. Providers of financial capital. Others interested in the organization's ability to create value will also benefit from the integrated report.

Scope. Generally, how strategy, governance, performance and prospects - together with external factors - influence the organization's ability to create value. Disclosures are guided more specifically by the eight Content Elements listed in Table 1. Where possible, information should be framed in terms of implications on future value creation, rather than only in terms of what is or has been.

The materiality approach in Integrated Reporting differs from that in financial statement reporting, where the subject matter is more precisely prescribed in international and national reporting standards. In financial reporting, the scope of information included is anchored to financial matters; therefore, so too are materiality decisions.

A common challenge expressed by organizations is that they apply a regulated and legal definition of materiality for financial and regulatory reporting, on the one hand, but another in the context of voluntary reporting, on the other. To manage this challenge, organizations can improve the efficiency of their business reporting by identifying where report strands are mutually supportive. For example, in applying their duty to disclose information under securities or corporate law, the board, supported by management, should consider how regulatory disclosures relate to the integrated report. Or, viewed the other way around, matters flagged as material in Integrated Reporting may be subject to disclosure under company and securities law.

Other frameworks can support the evaluation of content for integrated reports. International Financial Reporting Standards and accounting standards established by national standard setters can be used to compile financial information. Similarly, the Global Reporting Initiative's Sustainability Reporting Guidelines and the Sustainability Accounting Standards Board's sector-specific standards support the preparation of sustainability-related disclosures. Issue-specific standards also help compile key disclosures, such as the Greenhouse Gas Protocol, which is instrumental in terms of measuring and reporting on greenhouse gas emissions. The development of best practices and guidance in other areas, such as human capital, is emerging.

	Financial reporting			
	Financial statements	**Narrative report***	**Sustainability reporting**	**Integrated reporting**
Purpose	Communicate financial performance, position and cash flows in a specific reporting period	Provide context for financial statements and forward-looking information through the eyes of management	Communicate the entity's broader social and environmental impacts, strategies and goals	Explain to providers of financial capital how value is created over time
Audience	Current and prospective investors, lenders and other creditors	Current and prospective investors, lenders and other creditors	Investors (when including sustainability data in investor-focused communications) or multi-stakeholder (when preparing a stand-alone sustainability report)	Providers of financial capital. Others interested in the organization's ability to create value will also benefit
Scope	Information about: • Recognized assets • Liabilities • Equity • Income • Expenses • Changes in equity • Cash flows	• Risk exposure • Risk management strategies and the effectiveness of those strategies • Effect of beyond financial statement factors on operations and financial statement performance	Significant impacts in the following performance areas: • Economic • Environmental • Social, including labour practices, human rights and broader societal influences • Governance	Content Elements: • Organizational overview and external environment • Governance • Business model • Risks and opportunities • Strategy and resource allocation • Performance • Outlook • Basis of preparation and presentation

* For example, the Directors' Report, Management Commentary, Management's Discussion and Analysis, or Operating and Financial Review

Table 1. Comparison of common business reporting strands

Determining materiality

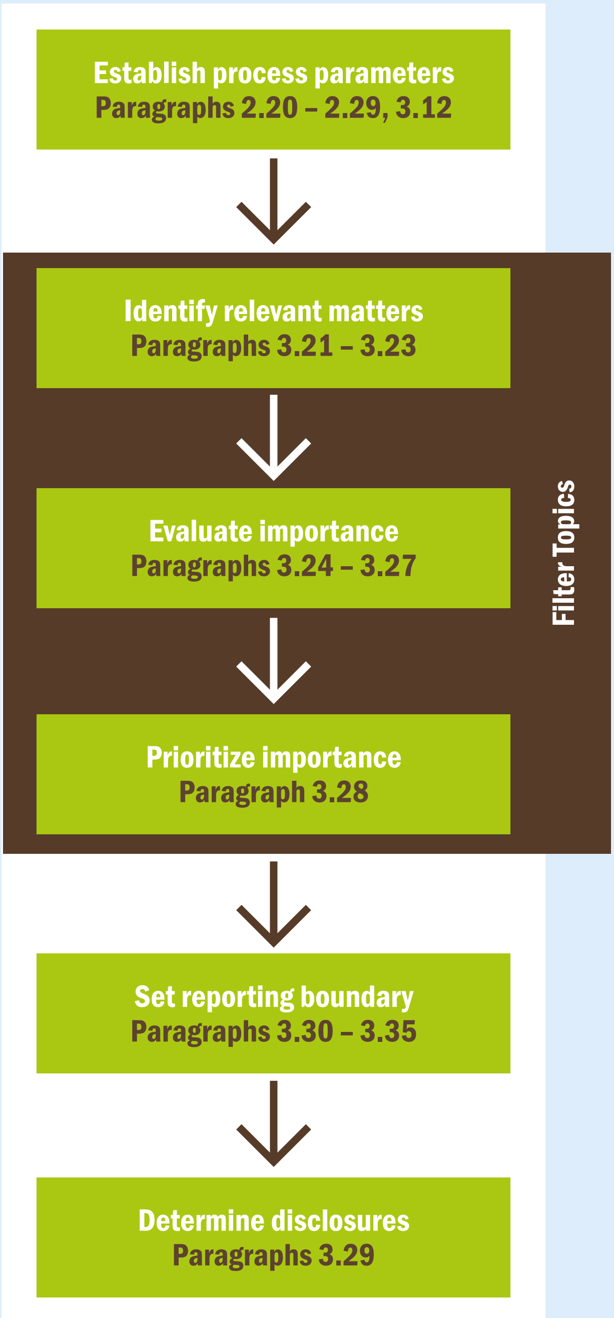
Integrated Reporting requires that organizations think beyond traditional financial reporting boundaries to identify the risks, opportunities and outcomes that could substantively affect their ability to create value over time.

In this section

- Establishing process parameters
- Filtering topics
- Setting the reporting boundary
- Determining disclosures
- Revisiting the process and its conclusions

The International <IR> Framework provides guidance for shaping report content. Figure 2 summarizes fundamental steps in the process, from establishing parameters of the materiality assessment to filtering matters (by identifying their relevance, evaluating their importance and prioritizing them based on their relative importance) to setting the reporting boundary and determining disclosures. Framework references are provided for each step.

Figure 2. Developing report content



Establishing process parameters

The first step in defining report content involves establishing the scope of the materiality determination process (i.e., the scope of the *process* itself, as opposed to the boundary around *disclosures* to be included in the report, as discussed under **Setting the reporting boundary**). Although not identified in this way in the Framework, this step is nonetheless implied. The Framework is explicit about the need for a materiality determination process; as with any process, clear parameters are needed.

A logical starting point is to identify the activities, performance and impacts of the **financial reporting entity**, including subsidiaries, joint ventures and investments over which the organization has control or significant influence. Establishing these parameters around the process for determining materiality not only helps to identify the inputs, business activities and outputs essential to value creation, but it also reveals key relationships with, for example, suppliers, strategic partners, communities and customers. Although engagement with stakeholders should already be embedded in the ordinary course of business, understanding the relative priority of stakeholders as they pertain to the materiality determination process is important.

Examining the financial reporting entity alone can be limiting, particularly when the ability to create value is significantly affected by supply chain activities. Integrated Reporting requires that organizations think beyond traditional financial reporting boundaries to consider the ways they influence value creation. As explained in **Section 1**, value should reflect the broader implications of activities and outputs on, for example, customers, communities and the natural environment. This can shift the focus of how an organization conducts its materiality determination process to ensure it explicitly contemplates supply chain, product life cycle and consumer value considerations.

Concepts in practice

In its **2014 Integrated Report,** Nedbank includes the following in its *Scope and Boundary of Reporting* statement:

Our ability to create value depends on certain forms of capital, how we use them and our impact on them. In this report we apply the capitals model, identified by the International Integrated Reporting Council, in managing and accessing our ability to create value over time. Our report aims to explain how we use and affect the capitals. We recognise that the capitals are interrelated and fundamental to the long-term viability of our business.

Intellectual capital is integrated into the human, financial and manufactured capitals as this better reflects the nature of our business as a financial services organization.

In assessing what is included in our integrated reporting we applied the principle of materiality. Accordingly the boundary of the report extends beyond financial reporting and includes non-financial performance, integrated sustainability development opportunities, risks, and outcomes attributable to or associated with all stakeholders that have a significant influence on the ability of Nedbank Group to create value.

Filtering topics

Having established the parameters of the materiality determination process, including the entities, activities and stakeholders to be considered, the organization follows three steps to filter key topics. As shown in Figure 2, the process involves *identifying, evaluating* and *prioritizing* relevant matters.

Identifying relevant matters

The Framework offers the following guidance on identifying relevant matters:

3.21 Relevant matters are those that have, or may have, an effect on the organization's ability to create value. This is determined by considering their effect on the organization's strategy, governance, performance or prospects.

3.22 Ordinarily, matters related to value creation that are discussed at meetings of those charged with governance are considered relevant. An understanding of the perspectives of key stakeholders is critical to identifying relevant matters.

3.23 Matters that might be relatively easy to address in the short term but which may, if left unchecked, become more damaging or difficult to address in the medium or long term need to be included in the population of relevant matters. Matters are not excluded on the basis that the organization does not wish to address them or does not know how to deal with them.

To identify relevant matters, consider topics or issues that:

- Could substantively affect value creation
- Link to strategy, governance, performance or prospects
- Are important to key stakeholders
- Form the basis of boardroom discussions
- May intensify or lead to opportunity loss if left unchecked

Concepts in practice

In its **2014 Annual Report** (p. 43), Novo Nordisk provides the following:

Novo Nordisk's business model is based on developing new, innovative products, and when the company makes significant new inventions, it will typically seek to patent them.

The report indicates that one of its strategic focus areas is to expand leadership and drug development in diabetes, a condition on the rise due to changes in eating habits and lifestyles. Novo Nordisk uses its annual report to communicate plans for diabetes prevention and treatment and the core capabilities underpinning this strategy.

Matters relevant to value creation are typically discussed at board meetings. Such matters will often be addressed in relation to the elements of the organization's value creation process and will likely be connected to the strategic themes and objectives of the organization. However, the process of identifying and understanding relevant matters is dynamic. **The matters on the board's agenda will not necessarily be complete at any given time, and stakeholders may have changing expectations, needs and interests. The current board agenda cannot necessarily be considered a full picture of all relevant matters.**

As noted in Paragraph 3.22 of the International <IR> Framework, understanding the perspectives of key stakeholders is critical to identifying, and better understanding, relevant matters. In their book, *The Integrated Reporting Movement: Meaning, Momentum, Motives, and Materiality,* Eccles and Krzus encourage a *Statement of Significant Audiences and Materiality* to highlight the stakeholder groups essential to organizational success and to place into context the board's judgements on materiality. When the board is clear in its communication of which stakeholders it feels are significant and, by implication, which are not, and which matters it believes are material in terms of value creation, investors gain insight into how the board judges relevance, and its ability to exercise this judgement.

Although a Statement of Significant Audiences and Materiality is not required under the International <IR> Framework, the statement may be used by some organizations in relation to *Section 3C – Stakeholder relationships and Section 4H – Basis of Preparation and Presentation.*

Comparing the topics identified to those reported on by peer organizations can help reduce the possibility of relevant matters being overlooked.

Having identified relevant matters, the next step is to evaluate their importance in terms of their known or potential effect on value creation.

Evaluating the importance of relevant matters

As a starting point, the International <IR> Framework provides the following guidance for assessing a matter's importance.

3.24 Not all relevant matters will be considered material. To be included in an integrated report, a matter also needs to be sufficiently important in terms of its known or potential effect on value creation. This involves evaluating the **magnitude** of the matter's effect and, if it is uncertain whether the matter will occur, its **likelihood** of occurrence.

3.25 Magnitude is evaluated by considering whether the matter's effect on strategy, governance, performance or prospects is such that it has the potential to substantively influence value creation over time. This requires judgement and will depend on the nature of the matter in question. Matters may be considered material either individually or in the aggregate.

3.26 Evaluating the magnitude of a matter's effect does not imply that the effect needs to be quantified. Depending on the nature of the matter, a qualitative evaluation might be more appropriate.

3.27 In evaluating the magnitude of effect, the organization considers:

- Quantitative and qualitative factors
- Financial, operational, strategic, reputational and regulatory perspectives
- Area of the effect, be it internal or external
- Time frame.

Evaluating the effect of a particular matter is not an exact science. It often requires judgement and depends on the nature of the topic or issue. In some situations, it may be cost prohibitive, impractical or otherwise inappropriate to quantify the effect of a particular matter with any degree of precision. In such cases, a *qualitative* rather than *quantitative* assessment may be more appropriate. A qualitative assessment might, for instance, explain the matter's influence on strategic objectives or how it has prompted a re-evaluation of the organization's business model.

> Evaluating the magnitude of a matter's effect does not imply that the effect needs to be quantified. Depending on the nature of the matter, a qualitative evaluation might be more appropriate.

Both quantitative and qualitative assessments are important in the evaluation of a matter's importance. **Quantitative** factors can be expressed in terms of *money* (e.g., sales, capital expenditures, return on investment), *operations* (e.g., production efficiency, output volume, capacity utilization) and *market competitiveness* (e.g., market share, customer volume, number of regions served) among others. **Qualitative** factors are descriptive and can provide important context and meaning. Such factors can include causal relationships between a given matter and the organization's social or legal licence to operate or continued access to key capitals. For example, the matters of regulatory infringements, corruption, workplace fatalities and environmental disasters can each erode reputation, sales opportunities and access to a skilled and engaged workforce.

When evaluating a matter's importance, the organization should consider the possible *nature*, *area* and *time frame* of its effect. Quantitative and qualitative factors should also be captured by the analysis as appropriate. Each factor is explored briefly here.

Nature of effects

Financial effects may be measured in monetary terms but could extend to financial ratios such as gross margin, liquidity ratios or credit risk.

Operational effects relate to business activities and processes that generate value. Their impacts are generally seen in related operational performance measures such as production volume, efficiency, safety performance or customer churn.

Strategic effects generally influence organizational plans or objectives. Such effects might, for example, influence the pursuit of increased market share, margin growth, emissions reduction, or new product development.

Reputational effects arise when initiatives or events, such as philanthropic programmes, product recalls or environmental infractions, improve or erode an organization's image, brand or social licence to operate.

Regulatory effects include those arising from legislative infractions or introduced by new laws or regulations. Examples include the infringement of civil or criminal regulations or changes brought about by more stringent emissions requirements.

Area of the effect

Internal effects relate to organizational efficiency or the continuity of operations, licence to operate, profitability or going concern. Examples may include improved operational efficiency through the introduction of new production technologies or downtime arising from prolonged labour disruptions.

External effects have an influence beyond the organization itself and can alter stakeholder perceptions. Such effects, like environmental degradation or improved community infrastructure through dedicated programs and contributions, can change public perception and affect the organization's access to key capitals.

Time frame of the effect

The time horizon of effects can vary according to the organization's industry, investment cycle, strategic objectives and expected outcomes. Mining projects for instance – which include exploration, feasibility, approvals, construction, production and reclamation activities – can span decades. By contrast, knowledge-intensive industries, such as telecommunications and software development, generally exhibit much shorter planning and investment cycles.

Some effects are relatively immediate. The enhancement of a particular workforce skill through focused training is one example. Others, such as the reversal of impacts on ecosystems, might take generations to accomplish.

With these considerations in mind, the following descriptions avoid assigning specific time frames; instead, organizations are encouraged to define time scales that suit their unique circumstances.

Short term effects include immediate, event-driven impacts, such as those arising from health and safety infractions or the identification of design flaws that prompt product recalls. For practical purposes, some organizations treat the annual reporting cycle as a suitable measure for the short term; this milestone provides an opportunity to share progress over the past year, as well as expectations between now and the next report.

Medium term effects are those that extend beyond the short term as defined by the organization. Such effects can manifest themselves over years through delayed, indirect or aggregated impacts. In terms of *delayed* effects, a manufacturer may find water shortages or high electricity costs manageable in the short term. However, sustained challenges might force the organization to invest in new technologies or make more permanent process changes over the medium term. As for *aggregated* effects, a single activity may have little influence on improving organizational reputation; but a culmination of factors, like a proven track record for quality, wise allocation of resources and effective marketing might, collectively, spur a reputational turnaround in the medium term.

Long term effects cover a more extensive time range and are generally more strategic than operational in nature. Again, the distinction between medium and long term effects is defined by the organization. An example of a long term consideration might be an extractive company's planned transition of its portfolio of investments to include renewable energy solutions, or climate mitigation and adaptation technologies.

Some matters, including historical performance or events or those mandated by regulation, are considered certain. In such cases, *importance* can be determined by assessing the magnitude of their effect on the ability to create value over time. Understanding the perspectives of key stakeholders is critical to this assessment, as is an awareness of the matter's link to, for example, strategy, business model and the capitals.

Concepts in practice

Occupational health and safety is generally considered a material issue in the mining industry. Naturally, its relative importance depends on the nature of the mine and related operations. The following simplified analysis demonstrates the thought process that guides the evaluation of relevant matters. Notably, the assessment of magnitude in this table draws on both quantitative and qualitative considerations.

Nature	Effect	Magnitude	Area	Time frame
Financial	• Direct costs for treatment, compensation, penalties, idle production, corrective action and insurance • Lost revenue from downtime	$10-20 million	Internal	Short Medium
Operational	• Disruption and restrictions arising from incidents and investigations	> 5% downtime > 1% rise in LTIFR*	Internal	Short
Strategic	• Diminished ability to continue, expand or compete due to regulatory sanctions and loss of confidence	Moderate erosion of regulatory and union relations	Internal	Short Medium
Reputational	• Loss of trust among employees, regulators and local communities	Moderate risk to public image	Internal External	Short Medium
Regulatory	• Penalties and restrictions imposed by regulators • Challenge securing or renewing permits and licences	High barriers due to repeated infractions	Internal	Medium Long

* Long term injury frequency rates

When it is uncertain whether an effect will occur, the potential magnitude of that effect should be considered and reasonable judgement applied. It is not always the case that highly probable matters are more important than others. As shown in a hypothetical example in **Figure 3**, despite its low likelihood of occurrence, Matter B is more important than Matter C, by virtue of its potentially severe or powerful effect on the organization's ability to create value.

When neither the magnitude nor the likelihood of a matter's effect is easily determined, the matter might still be material for reporting purposes. Such matters should not be excluded simply because their importance cannot be readily estimated or their effects are not expected in the short term.

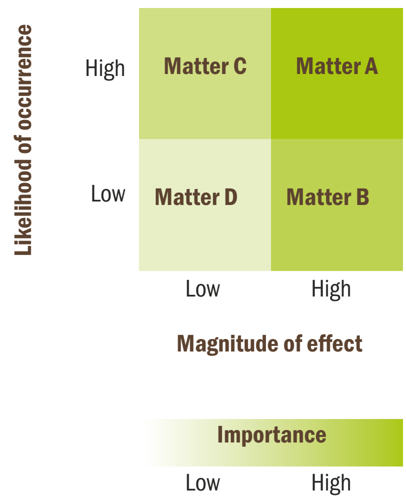


Figure 3. Illustrative example: Evaluating a matter's importance

When evaluating the importance of relevant matters, consider:

- Quantitative and qualitative effects
- The nature, area and time frame of effects
- The likelihood that effects will occur

Prioritizing relevant matters

Having determined the importance of relevant topics or issues, the priority of each should be established. Matters with the greatest effect, whether current or potential, on the organization's ability to create value are considered material for reporting purposes. The International <IR> Framework states:

3.28 Once the population of important matters is identified, they are prioritized based on their magnitude. This helps to focus on the most important matters when determining how they are reported.

Management and the board should ensure that the processes and evaluation criteria underpinning the prioritization are robust, such that material matters are brought to the organization's attention.

The prioritization of relevant matters serves two important functions. The first is that it drives a more formal understanding of the factors that influence value creation. In effect, the process introduces a mental discipline, one that encourages management and the board to critically analyze probabilities, causal relationships, synergies and trade-offs.

The second function of prioritization is to support focused, decision-useful report content, as discussed in **Section 1**. If the population of relevant matters seems unreasonably large, the act of rating or ranking will help determine if it is appropriate to narrow the population further. The ranking of issues will rely on entity-specific processes and criteria, as suggested below.

Concepts in practice

- According to its **2015 Annual Review** (p. 59), Stockland notes the following:

  An integrated reporting materiality workshop was held with members of the leadership team to identify any additional relevant issues, rank issues of greatest significance and prioritise them based on their ability to affect value. Material matters were mapped in terms of their potential impact on value creation over the short, medium and long term.

  Following the materiality workshop, the final list of material matters was presented to our internal Integrated Reporting Committee. Once confirmed, the matters were submitted to the Executive Committee and the Board for review. An alignment check was also performed, with our strategy review process and sustainability materiality outcomes.

- In its **2013 Annual Integrated Report** (p. 12), Standard Bank refers to a range of inputs to verify and prioritize issues, including:
  - a workshop with a selected group of external stakeholders
  - day-to-day engagements with external stakeholders
  - our code of ethics and values
  - our strategy
  - discussions among executive management
  - risk management and regulation
  - global challenges and national priorities
  - sustainability indices.

Setting the reporting boundary

Once the organization has identified the matters material to its ability to create value, it will need to define its boundary for reporting purposes. The International <IR> Framework provides the following guidance as a basis.

3.30 Key to the materiality determination process is the concept of the reporting boundary. Determining the boundary for an integrated report has two aspects:

- The financial reporting entity (i.e., the boundary used for financial reporting purposes)
- Risks, opportunities and outcomes attributable to or associated with other entities/stakeholders beyond the financial reporting entity that have a significant effect on the ability of the financial reporting entity to create value.

3.31 The financial reporting entity is central to the reporting boundary because:

- It is the financial reporting entity in which providers of financial capital invest and therefore need information about
- Using the financial reporting entity enables the information in the financial statements to serve as an anchor or point of reference to which the other information in an integrated report can be related.

As a starting point for defining the reporting boundary, the organization begins with the financial reporting entity, including the subsidiaries, joint ventures and associates within its control or significant influence. The extent to which these entities relate to the material matters identified (or, conversely, the extent to which the material matters relate to these entities) will help to shape report content. It is worth noting that some degree of iteration may be involved. As discussed in the **Establishing process parameters** section, defining the organizational boundary (using the financial reporting entity as a starting point) will inform the materiality determination process. This process will also be guided by ongoing engagement with stakeholders, a review of disclosures and other sources of information. These sources, and the corresponding conclusions, may prompt a re-evaluation of where the reporting boundary needs to extend beyond the financial reporting entity. This sentiment is explained in Paragraphs 3.34 and 3.35 of the Framework.

3.34 The second aspect of determining the reporting boundary is to identify those risks, opportunities and outcomes attributable to or associated with entities/stakeholders beyond the financial reporting entity that have a significant effect on the ability of the financial reporting entity to create value. These other entities/stakeholders might be "related parties" for the purpose of financial reporting, but will ordinarily extend further.

3.35 The purpose of looking beyond the financial reporting boundary is to identify risks, opportunities and outcomes that materially affect the organization's ability to create value. The entities/stakeholders within this portion of the reporting boundary are not related to the financial reporting entity by virtue of control or significant influence, but rather by the nature and proximity of the risks, opportunities and outcomes. For example, if aspects of the labour practices in the organization's industry are material to the ability of the organization to create value, then disclosure in the integrated report might include information about those aspects as they relate to suppliers' labour practices.

Determining disclosures

The preceding sections described the importance of establishing clear parameters for the materiality determination process, filtering relevant matters to those most impactful or likely to influence value creation over time and setting the reporting boundary. The final step involves the development of related report content to communicate to external audiences the material matters and their links to value creation. As shown in **Figure 4**, this content falls along three lines.

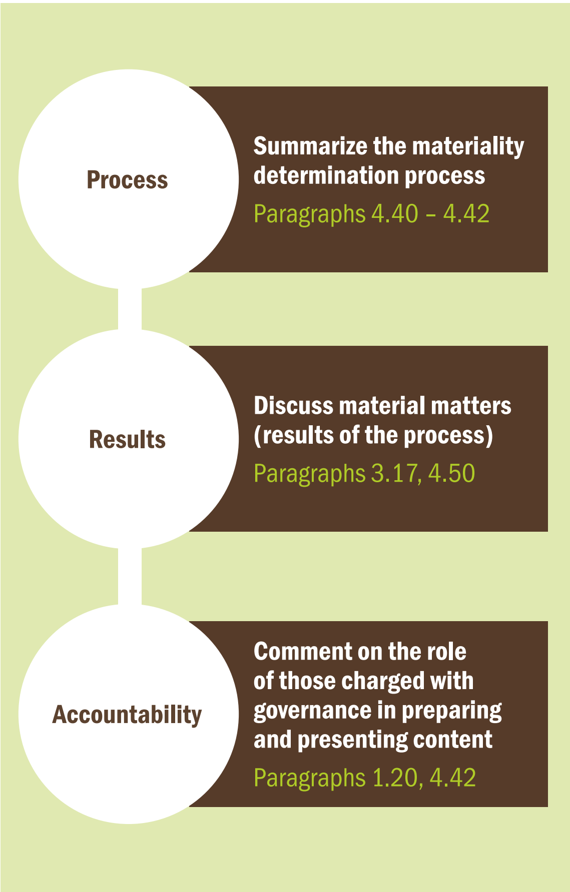


Figure 4. Expected materiality-related disclosures

Process-related disclosures

During the development of the International <IR> Framework, report users indicated that insights into the materiality determination process can be as important as the material matters themselves. In particular, providers of debt and equity financing indicated that process-related disclosures offer a glimpse into the quality of management and extent to which activities like stakeholder engagement are embedded into the business.

Paragraphs 4.40 and 4.42 of the Framework indicate expected disclosures about the organization’s materiality determination process.

4.40 An integrated report should answer the question: How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?

4.42 An integrated report includes a summary of the organization’s materiality determination process and key judgements (see paragraphs 3.18 - 3.20). This may include:

- Brief description of the process used to identify relevant matters, evaluate their importance and narrow them down to material matters
- Identification of the role of those charged with governance and key personnel in the identification and prioritization of material matters.

A link to where a more detailed description of the materiality determination process can be found may also be included.

Concepts in practice

In its **2015 Integrated Annual Report** (p. 50-55), Altron explains how the company:

- Defines its physical and impact boundaries
- Ranks stakeholders based on influence
- Gathers stakeholder views through internal documents, surveys and discussions
- Classifies issues as *material, priority, focus or controlled*
- Maps issues to value drivers and focus areas
- Evolves the process each year

Disclosures about material matters

Having identified the matters that significantly affect, or may affect, the organization's ability to create value over time, attention turns to developing meaningful disclosures about those matters. The International <IR> Framework provides the following related guidance.

4.50 Taking the nature of a material matter into consideration, the organization considers providing:

- Key information, such as:
  - an explanation of the matter and its effect on the organization's strategy, business model or the capitals
  - relevant interactions and interdependencies providing an understanding of causes and effects
  - the organization's view on the matter
  - actions to manage the matter and how effective they have been
  - the extent of the organization's control over the matter
  - quantitative and qualitative disclosures, including comparative information for prior periods and targets for future periods
- If there is uncertainty surrounding a matter, disclosures about the uncertainty, such as:
  - an explanation of the uncertainty
  - the range of possible outcomes, associated assumptions, and how the information could change if the assumptions do not occur as described
  - the volatility, certainty range or confidence interval associated with the information provided
- If key information about the matter is considered indeterminable, disclosure of that fact and the reason for it
- If significant loss of competitive advantage would result, disclosures of a general nature about the matter, rather than specific details.

When preparing disclosures, organizations should recognize the interplay between two core components of communication: **content** and **style**. In Integrated Reporting, the content component will be guided by:

- The materiality determination process, as described herein and in the International <IR> Framework
- The guidance on disclosing material matters provided in Paragraph 4.50 of the International <IR> Framework and reproduced herein
- Section 3F – *Guiding Principle, Reliability and completeness* in the International <IR> Framework (in particular, Paragraphs 3.47 – 3.53 on completeness).

On the other hand, the style component of communication relates to the emphasis placed on particular content and the clarity with which the message is delivered. These aspects are influenced by:

- The process of **prioritizing relevant matters**, which influences the prominence or level of detail a particular topic or issue receives
- Section 3B – *Guiding Principle, Connectivity*, of the International <IR> Framework, which requires that integrated reports show the combination, interrelatedness and dependencies between the factors that affect the organization's ability to create value over time
- Section 3E – *Guiding Principle, Conciseness*, of the International <IR> Framework, which encourages the use of plain language, effective report structure, cross-referencing and avoidance of generic or boilerplate disclosures.

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. It therefore contains material information, both financial and other.

Striking an effective balance between these considerations and establishing a comfortable reporting routine may take several iterations across multiple reporting cycles. Feedback from providers of financial capital and other users should indicate whether the integrated report is achieving its primary purpose and driving focused, decision-useful disclosures.

When developing report content:

- ☑ Consult the guidance provided in Paragraph 4.50 of the International <IR> Framework
- ☑ Ensure content meets the *Completeness* principle as described in Paragraphs 3.47–3.53 of the Framework
- ☑ Present information according to the matter's relative importance
- ☑ Demonstrate the connectivity of information per Paragraphs 3.6–3.9 of the Framework
- ☑ Consult Paragraphs 3.36–3.38 of the Framework for tips on achieving conciseness

Revisiting the process and its conclusions

The exercise of determining materiality for reporting purposes is not a trivial one; it entails research, consultation and judgement at each point along the way. Organizations generally cite a six- to twelve-month window to complete the process. Naturally, this range varies according to the organization's proficiency in the process, the depth and breadth of its external consultation and, importantly, the extent to which the process is embedded in the business.

Some organizations conduct a thorough assessment, completing each of the five steps in **Figure 2** in detail, every two to three years. In the interim, results of that assessment – and their continued validity given current circumstances – are revisited with each reporting cycle. For other organizations, the process is treated as a continuous cycle.

At a minimum, organizations should revisit the results of previous materiality assessments with each reporting cycle to ensure their continued applicability. The list of material matters should be modified to reflect new information or circumstances.

Although there is no hard and fast rule on how frequently or rigorously the materiality determination process should be conducted, a common sense approach should prevail. In particular, organizations should consider whether the following factors warrant a full-scale analysis including revisiting the parameters of the materiality determination process, identifying relevant matters and evaluating the importance and priority of those matters:

- When was a comprehensive materiality assessment last conducted? The simple passage of time, or *collective* influence of shifting factors – however minor in isolation – may justify a bottom-up analysis of material matters.
- Is the organization exposed to significant macroscopic fluctuations, including economic or consumer shifts, the emergence of new technologies or changes in the availability, quality or affordability of key capitals?
- Have entity-specific changes, such as a change in leadership, major acquisitions or divestments, revised business model or renewed strategies occurred since the last comprehensive materiality assessment?
- Has the relative importance of a particular stakeholder group shifted? Moreover, have the legitimate needs and interests of one or more stakeholder groups changed?
- Have new techniques or models for evaluating the magnitude of effects emerged since the last assessment?

When deciding on the depth and frequency of the materiality assessment, consider:

- ☑ The timing of the last comprehensive assessment
- ☑ The influence of external factors, including changes in economic conditions, resource availability or consumer tastes
- ☑ The influence of internal changes to leadership, strategy or business model
- ☑ Changes in the stakeholder profile, including revised needs and interests
- ☑ The emergence of new techniques for evaluating the magnitude of effects

Appendix

Examples of materiality-related disclosures

Organization	Sector	Report	Reference: Process	Reference: Results
Altron	Electrical equipment and telecommunications	Integrated Annual Report 2014	website	
Aveng	Infrastructure development	Integrated Report 2014	52–55	55–57
Clorox	Consumer products	Annual Report 2014	2	15–30
Crown Estates	Property management	Annual Report and Accounts 2015	website	48–49
Diageo	Alcoholic beverages	Annual Report 2014	16	16–19
Enagás	Gas utility	Annual Report 2014	26	27
EnBW	Electric utility	Annual Report 2013	3	41–43
Gold Fields	Mining	Integrated Annual Review 2014	4, 47-49	49–53
Hyprop	Real Estate Investment Trust	Integrated Report 2014	1, 27, 50	24–25
Itaú Unibanco	Banking and finance	Integrated Report 2014	16	16–34
Life Healthcare Group	Healthcare	Integrated Annual Report 2014	15	16–22
Sasol	Integrated energy and chemicals	Annual Integrated Report 2014	4	32
SK Telcom	Telecommunications	Annual Report 2014	132–33, 138–139	140–141
Standard Bank	Financial services	Annual Integrated Report 2013	2; 12	13
Stockland	Property development	Annual Review 2013	53	-
Telefonica	Telecommunications	Integrated Report 2014	40–41	40–41
Tsogo Sun	Gaming, hotel and entertainment	Integrated Annual Report 2014	2; 22	23-25
Vodacom	Telecommunications	Integrated Report 2014	-	14–15

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Visit the <IR> Examples Database

http://examples.integratedreporting.org

The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. Together, this coalition shares the view that communication about value creation should be the next step in the evolution of corporate reporting.

The International <IR> Framework has been developed to meet this need and provide a foundation for the future.

Further information about the IIRC can be found on its website www.integratedreporting.org

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