MATERIALITY ANALYSIS

The following guidance document is compiled from recent reports and tools to provide a road map for organizations wishing to identify the most material issues to inform their sustainability strategy and report.

Background:

Materiality analysis can help the organization to:

- Clarify issues driving long term business value
- Identify, prioritize and address risks
- Identify and capture opportunities
- Align sustainability and business strategies; help focus sustainability activities
- Build and maintain a strong brand and reputation
- Gain competitive advantage
- Anticipate and manage change
- Assess performance over time.

In terms of reporting, materiality can help in the following ways:

- Robust basis for identification of issues
- Shorter, more focused reports
- Greater assurance that key issues are covered
- Stronger integration between sustainability and annual reporting
- Rationale for use and selection of reporting standards and indicators.

The G3 defines material issues as "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". Materiality is the threshold at which an issue or indicator becomes sufficiently important that it should be reported. (Note that the GRI coined the expression "material" from the accounting profession where it is used in connection with financial reporting.)

By using a materiality analysis to identify and prioritize issues, the firm is better able to allocate space in its reports to those issues that are truly important to stakeholders and, by extension, the organization itself. The result is a shorter, more focused and better balanced report. The analysis will go a long way to fulfilling the purpose of assurance: to give stakeholders confidence that the company is addressing their concerns. Similarly,

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through a rigorous materiality analysis, firms can identify key issues for the development, upgrading and monitoring of their sustainability strategy.

The Process:

AccountAbility, a UK-based non-profit think tank, has proposed a five-part Materiality Test to help firms determine materiality, as follows:

Test 1: Direct Short-term Financial Impacts

- Short-term financial impacts resulting from aspects of social and environmental performance, e.g. carbon emissions have become "material" under this first test to an increasing number of companies.

Test 2: Policy-related Performance

- Policy statements of a strategic nature, for example CSR or environmental policies, and the nature of their implementation. The firm needs to consider the relevance of its own policies in determining what is material.

Test 3: Business Peer-based Norms

- Issues that a company's peers are deeming to be of material importance.

Test 4: Stakeholder Behaviour and Concerns

- Relevance to stakeholders in terms of reasonable evidence of likely impact on their decisions or behaviour.

Test 5: Societal Norms

- Societal norms that are embedded in regulation, are likely to become regulated in the future or are emerging norms within the investment community that could have an impact on access to capital. As well, international developments might reflect indications of emerging social norms, such as the UN Global Compact's nine principles.

AccountAbility's materiality report cited below suggests that company reporting can be categorized by one or many of these 5 tests and recommends that all parts of the test be applied. However, the authors acknowledge that companies are at different stages of development in their management of non-financial aspects of performance, thus a

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variation might be for the firm to set out a phased commitment to adopt all five parts of the test, clarifying their stage of adoption in their public report.

In the process of identifying material issues, a range of established methodologies can be used to assess their significance. In general, "significant impacts" refer to those that are a subject of established concern for expert communities, or that have been identified using established tools such as impact assessment methodologies or life cycle assessments. Impacts considered important enough to require active management or engagement by the organization are likely significant.

In practice, most firms prioritize issues by examining several factors, including the levels of stakeholder concern, societal concern, and impact on the organization; company policies and objectives, and the level of control the organization has over the issue. Of these, the two primary factors are stakeholder concern and impact on the organization.

1) Stakeholder concern; high stakeholder interest

Stakeholder concern is a significant determinant of whether an issue will be considered material. For that reason, firms typically begin by compiling a comprehensive list of stakeholders and the issues those stakeholders are most concerned about. Engagement with stakeholders is key to this process, e.g. through direct interaction, surveys, studies, conversations, and broader research on public perceptions around relevant issues. Ideally this effort takes place over a period of several months and becomes an ongoing, iterative process.

Some firms determine materiality based not only on the level of stakeholder concern over an issue, but also by how many stakeholders express concern over that issue. Another measure is to rank stakeholders based on their influence over and dependency on the company, which helps the company gauge the level of responsibility it has to individual stakeholder groups. Some combination of both approaches is likely best.

2) Impact on organization; impact of organization

Having identified stakeholder concerns, the company then assesses the impact of each issue on the organization. The company will usually consider impact in terms of the effect the issue has on its ability to execute its business strategy. In making this determination, the firm usually considers the issue in the context of overall business objectives and strategy, policies, risks, and current processes and programs. Some companies also factor in the amount of control they have over an issue to determine whether the issue is material.

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It is desirable that the firm's board of directors has considered the core dimensions of the firm's performance and sought appropriate guidance as to which if any are material and should therefore be reported. The afore-mentioned five-part materiality test provides a sound underpinning for this process.

Case Studies:

In evaluating an issue's materiality, BT considers the firm's sustainability policy, the financial impact on the company, and the degree of stakeholder as well as societal interest. BT invites a panel of external experts to assess how it should report on matters considered "material". This CSR leadership panel and the company's CSR steering group of senior managers together determine whether and how BT will report on issues identified as material. BT discusses issues identified as "*most* material" in both its printed and online reports and "material issues" only in its online report.

Starbucks defines material issues as those over which the firm has "reasonable control", albeit this can be considered stretching the definition of materiality too far: just because the firm can't control an issue, doesn't mean it is not material. In any case, Starbucks identifies issues through external and internal stakeholder input and through a consideration of company policies and strategies and the G3. In their 2006 report they consider three criteria in determining the materiality of their issues: significance or potential impact on Starbucks, significance to external stakeholders and the amount of "reasonable control" Starbucks has over a particular issue. The company discusses lower-priority items in its web-based report.

Ford Motor Company in its 2006/07 sustainability report defines material issues as those that have significant current or potential impact on the company in 3 – 5 years; those that are of significant concern to stakeholders; and those over which Ford has a reasonable degree of control. Ford discussed only those issues that rate "high" with regard to both stakeholder concern and company impact in its printed report. Other issues are discussed on its website.

Companies that ask stakeholders what they want in reports include: Allianz, Barclays, BMW, BP, BT, Exxon Mobil, Ford, Gap, GE, Pfizer, Rio Tinto, Starbucks, and Volvo.

Novo Nordisk defines materiality as "Those areas in which the company has a significant impact or where it has a responsibility and ability to act." If it is deemed "most material and business critical" it is included in the report. Ongoing stakeholder engagement and trendspotting help identify new issues which are or could become material to Novo Nordisk. The learning curve is a tool that aligns the process of defining materiality with

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integration into business practices. Emerging issues that are identified as relevant and potentially material are included at the bottom of the learning curve. Following a review of its implications for the firm's long-term business, a strategy is framed for those issues that are deemed material and subsequently data, indicators and targets are identified. Stakeholder engagement is part of this process. Once management of the issue has been embedded in the organization so that it is fully integrated into business processes, the strategy will be revisited as appropriate. Moreover, issues that are included on the learning curve are monitored as part of the integrated risk management process.

Input into Sustainability Strategy Development:

Having gone through this materiality analysis, firms could consider the degree to which the key issues could be incorporated into the firm's sustainability strategy. Many of the material issues could generate risks or opportunities for the firm and as such warrant consideration in strategy development. Similarly, the firm's priority sustainability initiatives could be an indicator of material issues for the firm and as such warrant consideration in the identification of material issues.

Input into Sustainability Reporting:

A sustainability report should emphasize information on performance regarding the most material topics. Other relevant topics can be included, but should be given less prominence in the report. Firms should explain the priority-setting process used for identifying and reporting material issues.

Adapted from: How to Measure What Matters, pp. 52 – 54, by Kathee Rebernak, Ethical Corporation, March 2008 issue, Canadian Corporate Sustainability Reporting, Best Practices 2008 (Stratos), G3 Definition of Materiality, Redefining Materiality: Practice and Public Policy for Effective Corporate Reporting by Simon Zadek and Mira Merme, and the Novo Nordisk 2007 Annual Report; Pathways: The GRI Sustainability Reporting Cycle: A Handbook for Small and Not So Small Organizations; Materiality – Building Clarity on Strategic Priorities, by Stratos.

APPENDIX A

MATERIALITY ANALYSIS FOR SUSTAINABILITY REPORTING WORKSHEET

1. Brainstorm a comprehensive list of stakeholders.

2. For each stakeholder group, list the main sustainability interests/topics/issues raised. If possible, consult stakeholders through surveys, focus groups, interviews, etc. Determine which issues are most significant to stakeholders and how many stakeholders express concern over key, significant issues. This step may take several months.

3. Rank the stakeholders based on their influence over and dependency on the company. This will help determine the level of responsibility your firm has to individual stakeholder groups. The higher the ranking the more material the stakeholder's interests and concerns.

4. Identify the main topics and future challenges for the sector reported by peers and competitors; relevant laws, regulations, international agreements or voluntary agreements with strategic significance to the organization and its stakeholders; likely sustainability impacts, risks, or opportunities (e.g. climate change, poverty) identified by experts; industry association priorities; media and stakeholder publications; interests of shareholder activists; external rankings and assessments.

5. Identify internal factors including key organizational values, policies, strategies, management systems, goals and targets; interests and expectations of stakeholders specifically invested in the success of the organization (e.g. employees, shareholders and suppliers); significant risks to the organization; critical factors that enable organizational success; and the core competencies of the organization and the manner in which they can or could contribute to sustainable development.

6. Assess the real or potential impact of the foregoing issues on your firm. Identify the issues that have significant current or potential impact on your firm in the next 3 – 5 years. Consider how they affect your company's ability to implement its business strategy, looking at the issue in the context of overall business objectives and strategy,

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policies, risks, current processes and programs. Those with the most real or potential impact on the ability of your firm to execute its strategy and those which will have the greatest social, environmental and economic impacts will be the most significant material issues.

You may wish to rank each issue against the following questions:

a) Is this already mentioned as important by stakeholders?
b) Does this constitute a future challenge for your sector; is it already discussed by peers?
c) Is this connected to relevant laws, regulations, international agreements or voluntary agreements with strategic significance to your organization or to your stakeholders?
d) Does this constitute and opportunity for your organization?
e) Does this contribute to the likelihood that a significant risk occurs?
f) Is this recognized by scientists/experts as a risk for sustainability?
g) Does your organization have specialized knowledge and competencies to contribute to sustainability in this area?
h) Does this contribute to successful implementation of your strategy or does this reinforce the "values" of your organization?

Add up the "yeses" to determine which are most material.

7. Consider inviting a panel of CSR experts to determine whether and how you should report on issues identified as material.

8. Discuss most material issues in your printed reports; delegate lesser material issues to your website. Your report should prioritize and focus on material topics and indicators.

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