MATERIAL FOR GROUP EXERCISE UNIT 2.2: KEY CONCEPTS AND DEFINITIONS IN NFIR

1. Form 4 groups and read the handed out material.

2. Elaborate a comprehensive definition (1-2 sentences) for:
   a. Materiality / material information (Group 1)
   b. Stakeholders (Group 2)
   c. Key performance indicators (Group 3)
   d. Value chain (group 4)

3. Underline the key words in your definition.

4. Choose one group member to present your results.

You have 15 minutes to complete this exercise.

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This approach recognises the broad diversity of businesses and sectors involved, and of circumstances that companies need to reflect in their reporting. Significant efforts have been made to avoid a 'one-size-fits-all' approach and an overly prescriptive methodology.

The guidelines recognise the importance of linkages and inter-relations of information (connectivity), whether it is between different aspects of non-financial information or between financial and non-financial information.

3 KEY PRINCIPLES

3.1 Disclose material information

Article 1 of the Directive states that companies concerned:

'[…] shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity […]'

Materiality is a concept already commonly used by preparers, auditors and users of financial information. A company's thorough understanding of the key components of its value chain helps identify key issues, and assess what makes information material.

Article 2(16) of the Accounting Directive (2013/34/EU) defines material information as 'the status of information where its omission or misstatement could reasonably be expected to influence decisions that users make on the basis of the financial statements of the undertaking. The materiality of individual items shall be assessed in the context of other similar items'.

The Directive introduces a new element to be taken into account when assessing the materiality of non-financial information by referring to *information 'to the extent necessary for an understanding of the […] impact of (the company's) activity'* ([1]).

Recital 8 of the Directive states that 'the undertakings which are subject to this Directive should provide adequate information in relation to the matters that stand out as being most likely to bring about the materialisation of principal risks of severe impacts, along with those that have already materialised ([2]). […]'.

The impact of a company's activity is a relevant consideration when making non-financial disclosures. Impacts may be positive or adverse. Material disclosures should cover both in a clear and balanced way. The non-financial statement is expected to reflect a company's fair view of the information needed by relevant stakeholders.

Material information must be assessed in a context. Information that may be material in one context may not be in another. Issues to be considered for inclusion in the non-financial statement are specific to the company's circumstances, taking into account concrete situations and sectoral considerations. Companies within an industry are likely to share similar environmental, social and governance challenges, for instance because of the resources they may rely upon to produce goods and services, or the effects they may have on people, society and the environment. It may therefore be appropriate to directly compare relevant non-financial disclosures among companies in the same sector.

Companies may report on a wide range of potential issues. A company assesses which information is material based on its analysis of how important that information is in understanding its development, performance, position and impact. This materiality assessment should take into account internal and external factors ([3]).

([1]) Article 1(1) of the Directive.

([2]) Recital 8 of the Directive also indicates that '[ ] the severity of such impacts should be judged by their scale and gravity. The risks of adverse impact may stem from undertaking's own activity or may be linked to its operations, and where relevant and proportionate, its products, services and business relationships, including its supply and subcontracting chains'.

([3]) For example, companies could use the preliminary analysis referenced in Annex I of the EMAS Regulation (Regulation (EC) No 1221/2009 of the European Parliament and of the Council of 25 November 2009 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32009R1221)

Materiality

1.3 The report shall cover topics that:

1.3.1 reflect the reporting organization's significant economic, environmental, and social impacts; or

1.3.2 substantively influence the assessments and decisions of stakeholders.

Guidance

An organization is faced with a wide range of topics on which it can report. Relevant topics, which potentially merit inclusion in the report, are those that can reasonably be considered important for reflecting the organization's economic, environmental, and social impacts, or influencing the decisions of stakeholders. In this context, 'impact' refers to the effect an organization has on the economy, the environment, and/or society (positive or negative). A topic can be relevant – and so potentially material – based on only one of these dimensions.

In financial reporting, materiality is commonly thought of as a threshold for influencing the economic decisions of those using an organization's financial statements, investors in particular.

A similar concept is also important in sustainability reporting, but it is concerned with two dimensions, i.e., a wider range of impacts and stakeholders. In sustainability reporting, materiality is the principle that determines which relevant topics are sufficiently important that it is essential to report on them. Not all material topics are of equal importance, and the emphasis within a report is expected to reflect their relative priority.

A combination of internal and external factors can be considered when assessing whether a topic is material. These include the organization's overall mission and competitive strategy, and the concerns expressed directly by stakeholders. Materiality can also be determined by broader societal expectations, and by the organization's influence on upstream entities, such as suppliers, or downstream entities, such as customers. Assessments of materiality are also expected to take into account the expectations expressed in international standards and agreements with which the organization is expected to comply.

These internal and external factors are to be considered when evaluating the importance of information for reflecting significant economic, environmental, and/or social impacts, or for stakeholders' decision making. Various methodologies can be used to assess the significance of impacts. In general, 'significant impacts' are 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 that are considered important enough to require active management or engagement by the organization are likely to be considered significant.

Applying this principle ensures that the report prioritizes material topics. Other relevant topics can be included, but with less prominence. It is important that the organization can explain the process by which it determined the priority of topics.

Figure 3 presents an example matrix, for guidance purposes. It shows the two dimensions for assessing whether a topic is material; and that a topic can be material based on only one of these dimensions. The use of this exact matrix is not required; however, to apply the Materiality principle, it is required to identify material topics based on these two dimensions.

Disclosure 102-46 and clause 6.1 in *GRI 102: General Disclosures* require an explanation of how the Materiality principle has been applied.

Tests

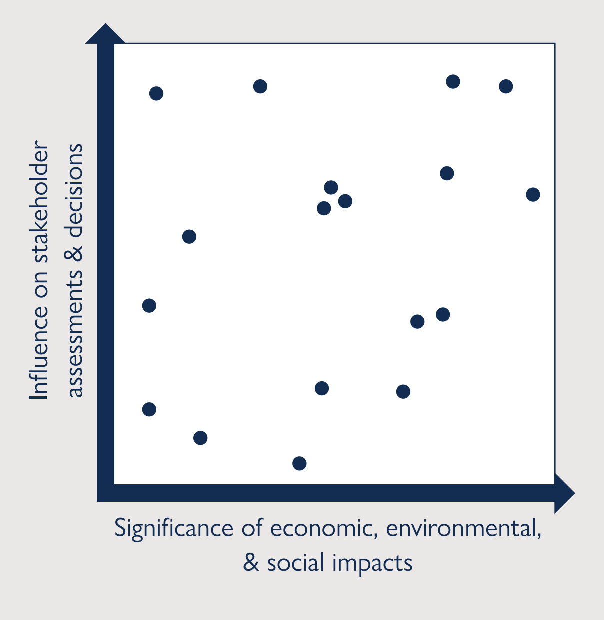
In defining material topics, the reporting organization has taken into account the following factors:

- Reasonably estimable economic, environmental, and/or social impacts (such as climate change, HIV-AIDS, or poverty) identified through sound investigation by people with recognized expertise, or by expert bodies with recognized credentials;
- The interests and expectations of stakeholders specifically invested in the organization, such as employees and shareholders;
- Broader economic, social, and/or environmental interests and topics raised by stakeholders such as workers who are not employees, suppliers, local communities, vulnerable groups, and civil society;
- The main topics and future challenges for a sector, as identified by peers and competitors;
- Laws, regulations, international agreements, or voluntary agreements of strategic significance to the organization and its stakeholders;
- Key organizational values, policies, strategies, operational management systems, goals, and targets;
- The core competencies of the organization and the manner in which they can contribute to sustainable development;

Materiality
Continued

- Consequences for the organization which are related to its impacts on the economy, the environment, and/or society (for example, risks to its business model or reputation);
- Material topics are appropriately prioritized in the report.

Figure 3
Visual representation of prioritization of topics



Example

A company may disclose relevant information based on the expected impact of science-based climate change scenarios on its strategies and activities. Alternatively, it may disclose targets for reducing the number of occupational accidents or diseases.

3.5 **Stakeholder orientated**

Companies are expected to consider the information needs of all relevant stakeholders. They should focus on information needs of stakeholders as a collective group, rather than on the needs or preferences of individual or atypical stakeholders, or those with unreasonable information demands.

As appropriate, this may include, among others: investors, workers, consumers, suppliers, customers, local communities, public authorities, vulnerable groups, social partners and civil society.

Companies should provide relevant, useful information on their engagement with relevant stakeholders, and how their information needs are taken into account. For instance, ISO 26000 and the OECD Guidelines for Multinational Enterprises provide useful guidance on this.

Example and KPIs

A company may disclose material information on its engagement with stakeholders, and explain how this influences its decisions, performance and the impact of its activities.

3.6 **Consistent and coherent**

The non-financial statement is expected to be consistent with other elements of the management report.

Making clear links between the information presented in the non-financial statement and other information disclosed in the management report makes the information more useful, relevant and cohesive. The management report should be viewed as a single, balanced and coherent set of information.

As contents are related to each other, explaining key linkages makes it easier for investors and other stakeholders to understand material information and interdependencies.

The content of the non-financial report should be consistent over time. This enables users of information to understand and compare past and present changes in a company's development, position, performance and impact, and relate reliably to forward-looking information.

Consistency in the choice and methodology of KPIs is important to ensure that the non-financial statement is understandable and reliable. However, updates may be necessary, as KPIs may become obsolete, or new and better methodologies be developed that improve the quality of information. Companies are expected to explain any changes in reporting policy or methodology, the reasons for changing them and their effects (for example by restating past information, clearly showing the effect of changing reporting policies or methodologies).

Example

A company may identify relationships and linkages between its business model and corruption and bribery aspects.

4 **CONTENT**

Companies are expected to identify the specific thematic aspects and material information to be included in their disclosures in a fair, balanced and comprehensive manner, including by engaging with relevant stakeholders.

Information in the non-financial statement is interconnected. For instance, outcomes reflect not only what a company does (through its business model, policies and strategies), but also the company's specific circumstances and risks, and how effective it is at managing those risks. Explaining key linkages and interdependencies improves the quality of the report.

Principles for defining report content

Stakeholder Inclusiveness

1.1 The reporting organization shall identify its stakeholders, and explain how it has responded to their reasonable expectations and interests.

Guidance

Stakeholders are defined as entities or individuals that can reasonably be expected to be significantly affected by the reporting organization's activities, products, or services; or whose actions can reasonably be expected to affect the ability of the organization to implement its strategies or achieve its objectives. This includes, but is not limited to, entities or individuals whose rights under law or international conventions provide them with legitimate claims vis-à-vis the organization.

Stakeholders can include employees and other workers, shareholders, suppliers, vulnerable groups, local communities, and NGOs or other civil society organizations, among others.

When making decisions about the content of its report, the organization is to consider the reasonable expectations and interests of stakeholders. This includes those who are unable to articulate their views and whose concerns are presented by proxies (for example, NGOs acting on their collective behalf); and those with whom the organization cannot be in constant or obvious dialogue. The organization is expected to identify a process for taking such views into account when determining whether a topic is material.

A process of stakeholder engagement can serve as a tool for understanding the reasonable expectations and interests of stakeholders, as well as their information needs. An organization typically initiates different types of stakeholder engagement as part of its regular activities, which can provide useful inputs for decisions on reporting. These include 'routine' engagements to inform ongoing organizational or business processes.

Stakeholder engagement based on systematic or generally accepted approaches, methodologies, or principles can also be implemented specifically to inform the preparation of the report. Other means that can be used to satisfy this principle include monitoring the media, engaging with the scientific community, or collaborative activities with peers and stakeholders. The overall approach is to be sufficiently effective so that stakeholders' information needs are properly understood.

It is important that the means used are capable of identifying direct input from stakeholders as well as legitimately established societal expectations. Moreover, an organization can encounter conflicting views or expectations among its stakeholders, and is expected to be able to explain how it balanced them when making decisions about its reporting.

For it to be possible to assure the report process and data, it is important for the organization to document its approach for identifying stakeholders; deciding which stakeholders to engage with, and how and when to engage with them; and how engagement has influenced the report content and the organization's activities, products, and services.

Systematic stakeholder engagement, executed properly, is likely to result in ongoing learning within the organization, as well as increased accountability to a range of stakeholders. Accountability strengthens trust between the organization and its stakeholders. Trust, in turn, strengthens the credibility of the report.

Tests

- The reporting organization can describe the stakeholders to whom it considers itself accountable;
- The report content draws upon the outcomes of stakeholder engagement processes used by the organization in its ongoing activities, and as required by the legal and institutional framework in which it operates;
- The report content draws upon the outcomes of any stakeholder engagement processes undertaken specifically for the report;
- The outcome of the stakeholder engagement processes that inform decisions about the report are consistent with the material topics included in the report.

Disclosures, where relevant and proportionate, should include material information on supply and subcontracting chains. They should also include material information on how a company manages and mitigates principal risks.

A company is expected to highlight and explain any material changes to its principal risks, or to the way it manages them, in the reporting year.

Example and KPIs

A company may consider including specific disclosures on:

— malfunctioning products with possible effects on consumers' safety;

— policies implemented to address the issue;

— remediation measures addressing the needs of consumers already affected by those products.

Example and KPIs

A company may consider disclosing material information on climate-related impacts on its operations and strategy, taking into account its specific circumstances and including appropriate assessments of likelihood and use of scenario analyses [1].

Example and KPIs

A company may consider disclosing material information on risks of harm related to human rights, labour and environmental protection in its supply and subcontracting chain, and on how the company manages and mitigates potential negative impacts.

4.5 Key performance indicators

Article 1 of the Directive states that the non-financial statement must contain information including:

e. *'non-financial key performance indicators relevant to the particular business;'*

The non-financial statement should include material narratives and indicator-based disclosures, commonly referred to as key performance indicators (KPIs).

Companies are expected to report KPIs that are useful taking into account their specific circumstances. The KPIs should be consistent with metrics actually used by the company in its internal management and risk assessment processes. This makes the disclosures more relevant and useful, and improves transparency. Disclosing high quality, broadly recognised KPIs (for instance, metrics widely used in a sector or for specific thematic issues) could also improve comparability, in particular for companies within the same sector or value chain.

A company should disclose KPIs that are necessary to understand its development, performance, position and impact of its activity. Some KPIs may be useful for a wide variety of companies and business circumstances. Other KPIs relate more to the issues and circumstances of a given sector. Companies are encouraged to disclose material KPIs, both general and sectoral. Considering their specific circumstances and the information needs of investors and other stakeholders, companies are expected to provide a fair and balanced view by using general, sectoral and company-specific KPIs.

Users of information tend to greatly appreciate quantitative information as it helps them measure progress, check consistency over time and draw comparisons. Appropriate narratives explaining KPIs help make the non-financial statement more understandable.

[1] For further reference, see conclusions of the industry-led Task Force on Climate-related Financial Disclosures organised by the FSB.

KPIs are also considered effective tools to connect qualitative and quantitative information, and to build linkages. They enable companies to provide a balanced and comprehensive view in a concise and effective manner.

KPIs should be used consistently from one reporting period to the next in order to provide reliable information on progress and trends. The KPIs reported may, of course, evolve over time for business or technical reasons. In these cases, companies should explain the reasons why KPIs changed. They may consider resetting past information where appropriate, and explaining clearly and effectively the effect of these changes.

Companies may explain data collection, methodology and the frameworks relied upon. They may also provide an analysis of the KPIs disclosed, explaining for example why KPIs increased or decreased in the reporting year, and how KPIs might evolve in the future.

Companies may present KPIs in the context of targets, past performance, and comparison with other companies, as appropriate.

Example and KPIs

A company may consider appropriate disclosures on metrics and targets used to assess and manage relevant environmental and climate-related matters [1].

4.6 Thematic aspects

Article 1 of the Directive states that companies concerned 'shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters […]'.

Material disclosures should provide a balanced and comprehensive view of a company's development, performance, position, and the impact of its activities.

In certain circumstances companies may consider that disclosing detailed information about impending developments or matters under negotiation would be seriously prejudicial. However, disclosing summarised information that is not seriously prejudicial may go a long way towards meeting the overall transparency objective.

Article 1 of the Directive provides that 'Member States may allow information relating to impending developments or matters in the course of negotiation to be omitted in exceptional cases where […] the disclosure of such information would be seriously prejudicial to the commercial position of the undertaking […].'

Thematic aspects are often interconnected. For instance, an environmental issue related to a company's operations, products or supply chain may also have an impact on the safety and/or health of consumers, employees, or suppliers, or on brand reputation. Companies are expected to provide a clear, fair and comprehensive view that encompasses all relevant aspects of an issue.

The following items constitute a non-exhaustive list of thematic aspects that companies are expected to consider when disclosing non-financial information:

a. *Environmental matters*

A company is expected to disclose relevant information on the actual and potential impacts of its operations on the environment, and on how current and foreseeable environmental matters may affect the company's development, performance or position.

This may include:

— material disclosures on pollution prevention and control;

— environmental impact from energy use;

(1) For further reference, see conclusions of the industry-led Task Force on climate-related financial disclosures organised by the FSB.

- The Directive requires undertakings to 'provide adequate information in relation to matters that stand out as being most likely to bring about the materialization of principal risks of severe impacts, along with those that have already materialized.'

  The GRI Standards also place the concept of materiality at the heart of sustainability reporting. Under GRI's **Materiality principle**, material topics are determined as those which reflect the organization's significant economic, environmental and/or social impacts; or which substantively influence the assessments and decisions of its stakeholders.

  Key stakeholders have a vital role to play in informing an organization's materiality assessment. Taking their views into account is crucial for developing a proper understanding of the organization's impacts, and how they relate to its business model and strategy.

- **Impacts in the value chain**
  The value chain is another important theme. According to the Directive, once the materiality of a sustainability subject has been established by an awareness of its actual or potential impact, 'The severity of such impacts should be judged by their scale and gravity. The risks of adverse impact may stem from the undertaking's own activities or may be linked to its operations, and, where relevant and proportionate, its products, services and business relationships, including its supply and subcontracting chains.'

  Further, the Directive calls for statements and reports to 'also include information on the due diligence processes implemented by the undertaking, also regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts.'

  The GRI Standards place a similar emphasis on due diligence processes and the value chain. Organizations are asked to report not only on impacts they cause directly, but also those they contribute to, or are linked to via business relationships, such as with suppliers or customers.[4]

  Extending a materiality assessment to include the value chain helps an organization to understand where its biggest impacts occur, regardless of whether those impacts are within its direct control.

  In recent years, this conceptual change has been heavily influenced by the UN Guiding Principles on Business and Human Rights. The resulting focus of the Directive and of the GRI Standards aims to ensure that the outsourcing of production does not permit the outsourcing of responsibility.

- **Exceptions and omissions**
  Both the Directive and the GRI Standards acknowledge circumstances in which it may not be possible to disclose certain information. The Directive gives governments the option to allow companies not to disclose information related to impending developments, or matters under negotiation. Such information can be omitted in exceptional cases and under specific conditions. Furthermore, a 'report or explain' approach can be used when an undertaking has no policies on sustainability matters: the company can explain why.

  Similarly, GRI recognizes that in exceptional cases it may not be possible to disclose certain information. In those cases, a report is expected to clearly identify the information that has been omitted, along with the specific reason for omission.[5] ***GRI 101: Foundation*** sets out the reasons for omission which can be used.

- **External assurance**
  The Directive and the GRI Standards maintain flexibility regarding the use of external assurance. The Directive allows Member States to decide whether independent assurance of the disclosed information is a requirement. Within the GRI Standards, external assurance is recommended, but not required for a report to be considered 'in accordance' with the GRI Standards.

- **Continuous improvement**
  The Directive is careful to encourage further improvements to the transparency of undertakings' non-financial information. By its nature, this is a continuous endeavor.

  Sustainability reporting that is truly integrated into an organization's strategy, and which helps to empower more sustainable decision-making, is also a long-term endeavor. The GRI Standards offer the flexibility needed to support organizations as they transition from being first-time reporters to developing a more comprehensive and meaningful sustainability reporting practice.

4 See ***GRI 103: Management Approach***, Disclosure 103-1 for more information.
5 See ***GRI 101: Foundation***, Section 3 for more information on reasons for omission.