FREQUENTLY ASKED QUESTIONS

Proposed ISSA 5000: The Application of Materiality by the Entity and the Assurance Practitioner

How does the concept of materiality apply to sustainability reporting and related assurance engagements?

Materiality is a fundamental concept that is applied by the entity in preparing and presenting sustainability information and by assurance practitioners in planning and performing a sustainability assurance engagement.

Materiality is a user-driven concept – that is, materiality, is affected by perceptions of the information needs of intended users of the sustainability information. Unless the sustainability reporting framework (or other applicable criteria) defines or describes it differently, the concept of materiality ordinarily includes the following principles:

- Judgments about matters that are material to intended users of the sustainability information are based on a consideration of the common information needs of intended users as a group.
- Misstatements, including omissions, are considered material if they, individually or in the aggregate, could reasonably be expected to influence decisions of intended users taken on the basis of the sustainability information.

Both the entity and the assurance practitioner make judgments about materiality in this context.

How does the entity apply materiality when determining the sustainability matters to be included in the sustainability report?[1]

Sustainability reporting frameworks ordinarily will include requirements for the entity to disclose information about sustainability matters when such information is material. The entity's judgments about what is material are specific to the entity's facts and circumstances. This includes judgments to determine the specific topics (e.g., climate, biodiversity, labor practices, human rights) and aspects of those topics (e.g., risks and opportunities, governance, targets, metrics and key performance indicators) to be reported. Unless otherwise required by the reporting framework, an entity need not provide a specific disclosure if the information is not material.

[1] As explained in ED-5000, current practice in reporting of sustainability information varies widely, from inclusion in an integrated report or the annual report, such as within management commentary, to a stand-alone sustainability report or report on a specific topic. The reference to "sustainability report" here is intended to encompass all sustainability reporting mechanisms.

The entity's process for identifying the matters to disclose may be referred to as the "materiality process," or "materiality assessment," among other terms. The "materiality process" takes into account the entity's understanding of the intended users of the sustainability information and their information needs. In applying this process, the entity may conclude that information is material for various reasons. Those reasons include the nature or magnitude of the sustainability matters reported, or a combination of both, judged in relation to the particular circumstances of the entity and the information needs of intended users. Therefore, the materiality judgments made by the entity involve both quantitative and qualitative considerations. The entity's "materiality process" also includes consideration of whether the reporting framework is sufficiently specific on its own or whether it needs to be supplemented with entity-developed criteria (i.e., whether the criteria are suitable in the engagement circumstances). As explained in ED-5000, criteria are suitable when they lead to sustainability information that is relevant (i.e., assists users' decision-making), complete (i.e., does not omit relevant factors that could reasonably be expected to affect the decisions of intended users), reliable (i.e., appropriately measured, evaluated or described), neutral (i.e., free from bias as appropriate in the circumstances) and understandable (i.e., presented clearly and concisely and in a manner that does not obscure relevant information).

What is "double materiality"?

The reporting framework may require the entity to apply the concept of "double materiality," which recognizes that stakeholders may be focused on financial materiality or impact materiality or both. Financial materiality relates to the financial impact of sustainability matters on the entity and impact materiality relates to the positive or negative impacts of the entity on the environment, society, economy or culture. The application of "double materiality" means that the entity's "materiality process" needs to consider both financial materiality and impact materiality when identifying the sustainability matters to be disclosed and may therefore require outreach with stakeholders.

How does the entity apply materiality when preparing and presenting the sustainability information?

The entity's "materiality process" does not only relate to identifying the sustainability matters to be disclosed. The "materiality process" also includes the appropriate application of materiality in the preparation and presentation of the sustainability information in accordance with the reporting framework or other suitable criteria. This involves the establishment of processes and controls to drive the appropriate application of the criteria and that generate sustainability information that is not materially misstated.

Is the entity's "materiality process" different from the practitioner's application of materiality?

The concept of materiality is the same for the entity and the practitioner (i.e., it is a user-driven concept, that is, it is affected by perceptions of the information needs of intended users of the sustainability information). Although the requirements of the reporting framework provide a frame of reference for the entity's and assurance practitioner's judgments about materiality (e.g., financial materiality, impact materiality or both), the entity's "materiality process" is not the same as the application of materiality by the practitioner.

The entity's "materiality process" is focused identifying the sustainability matters to be disclosed. The practitioner considers or determines materiality in developing the approach for obtaining evidence and when evaluating identified misstatements of the sustainability information. As a result, qualitative factors considered by the entity and the practitioner may overlap but need not be identical. For quantitative disclosures, the practitioner and entity will not necessarily arrive at the same materiality threshold (i.e., the entity uses a threshold to determine, for example, whether certain metrics or targets should be reported and whether they are properly disclosed in accordance with the reporting framework, while the practitioner uses a threshold when obtaining evidence about the metrics and targets that are reported by the entity and evaluating identified misstatements in that information).

How does the practitioner apply materiality in a sustainability assurance engagement?

Materiality is applied by assurance practitioners in planning and performing a sustainability assurance engagement, including when performing risk procedures, determining the nature, timing and extent of further procedures, and evaluating whether the sustainability information is free of material misstatement.

ED-5000 requires the practitioner to consider materiality for qualitative disclosures, and to determine materiality for quantitative disclosures. This "bifurcated" approach was deemed to be appropriate because it is impracticable for practitioners to determine materiality for qualitative disclosures given the nature of those disclosures, and impracticable to determine a single materiality for the sustainability information as a whole due to a mix of qualitative and quantitative disclosures about a number of different topics and aspects of topics. For quantitative disclosures, the practitioner is also required to determine performance materiality.

As a practical matter, a sustainability assurance engagement ordinarily involves multiple materialities. Not all disclosures have the same materiality considerations. For different disclosures, the same intended users may have different information needs, a different tolerance for misstatement, or the disclosures may be expressed using different units of measure. For example, intended users may have a lower tolerance for misstatement of information about food or drug safety than about recycling of non-hazardous waste.

If the notion of double materiality is relevant to the engagement, the practitioner applies a double materiality "lens" (i.e., "looks both ways" at financial materiality and impact materiality) but considers or determines a single materiality for purposes of planning and performing procedures at the disclosure level and evaluating whether identified misstatements are material. If both financial and impact materiality apply:

- For quantitative disclosures, ordinarily the lesser of financial or impact materiality would be used as that would be material to intended users or other affected stakeholders.
- For qualitative disclosures, the factors described in ED-5000 (see the qualitative factors in paragraph A278 and other misstatement considerations in paragraphs A417-A419) apply. A key consideration is whether the disclosures are accurate and complete (i.e., do not omit information

that may affect the users' decisions), and do not include information that obscures the presentation of the disclosures.

How does the practitioner consider the entity's "materiality process" during a sustainability assurance engagement?

There is no single evaluation of the "materiality process." Rather, the practitioner obtains evidence about the entity's "materiality process" at several different times throughout the assurance engagement, including, for example:

- *As part of the engagement acceptance and continuance procedures*, when evaluating whether the reporting framework (i.e., applicable criteria) that the practitioner expects to be applied in the preparation of the sustainability information is suitable for the engagement circumstances and will be available to intended users. ED-5000 notes that, in obtaining a preliminary knowledge of the sustainability information expected to be reported, the practitioner may consider whether the topics and aspects of topics to be reported, and the reporting boundaries, have been or will be determined by management through an appropriate process.
- *When obtaining an understanding of the entity's policies or procedures to identify (or develop) and apply the applicable criteria.* This understanding helps the practitioner evaluate whether the entity's policies or procedures (including those related to identifying the relevant topics and aspects of topics to be disclosed) are appropriate in the circumstances and are consistent with the applicable criteria. This understanding also helps the practitioner in identifying the susceptibility of the entity's disclosures to misstatement.
- *When obtaining an understanding of the entity's system of internal control* relevant to the identification and preparation of the sustainability information to be reported. This would include obtaining an understanding the information system and related processes used to prepare the sustainability information.
- *When performing further procedures* to obtain sufficient appropriate evidence about whether the requirements of the reporting framework have been applied properly in preparing and presenting the sustainability information; and
- *When evaluating misstatements* identified during the engagement to determine whether uncorrected misstatements, individually or in aggregate, are material. This involves professional judgment and the consideration of quantitative and qualitative factors in the context of the reporting framework (i.e., applicable criteria) and the engagement circumstances, including the intended users and what disclosures are likely to be important. Importantly, ED-5000 notes that misstatements can arise from error or fraud, may be qualitative or quantitative, and include omitted information or information that obscures the presentation of the disclosures.

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