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Making Materiality Determinations

A Context-Based Approach

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Sustainable Development Performance Indicators

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Introduction to Working Papers on Sustainable Development Performance Indicators

This paper is part of a series of outputs from the UNRISD research project on Sustainable Development Performance Indicators.

The project seeks to contribute to assessing and improving methodologies and indicator systems that measure and evaluate the performance of a broad range of economic entities in relation to the vision and goals of the 2030 Agenda for Sustainable Development. It assesses the adequacy of existing methods and systems for gauging the contribution of enterprises to achieving the Sustainable Development Goals (SDGs); seeks to expand the scope of sustainability measurement, disclosure and reporting beyond for-profit enterprises to encompass enterprises and organizations that make up the social and solidarity economy (SSE); identifies data points and indicators related to SSE that may inform conventional approaches to sustainability measurement associated with for-profit enterprises; and proposes and tests a set of sustainable development impact indicators that can address key sustainable development challenges of the early 21st century.

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Abstract

Arguably the most important step in the measurement and reporting of an organization's performance is completion of a materiality determination beforehand. At base, materiality determinations address the all-important question of what the scope and criteria for analysis must be in each case, recognizing that in principle no two organizations are alike. Materiality determinations therefore address the question of what the organization-specific standards of performance should be – whether social, economic or environmental – and what the corresponding metrics or indicators, too, should be in order to fully assess performance. Even in cases where purportedly universal indicators are being used, the very choice of which ones to in fact use presupposes their relevance. In this paper, we present and advocate for a specific approach for how best to make materiality determinations that are, in the parlance of sustainability management, context-based. As such, the method proposed is normative and triple bottom line in scope, in that it holds organizations accountable for their impacts on all vital capitals and with the well-being of all stakeholders in mind.

Keywords

Context-based sustainability; Impact valuation; Integrated reporting; Materiality; Performance accounting: Rightsholders; Stakeholders; Sustainability accounting; Triple bottom line; Vital capitals.

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Contents

Acronyms

AOI	Area of impact
BIA	B Corp Business Impact Assessment
CBS	Context-based sustainability
CI	Categorical imperative
D/Ds	Duty/duties
ECG	Economy for the Common Good
FFBB	Future-Fit Business Benchmark
GHG	Greenhouse gas
GRI	Global Reporting Initiative
IIRC	International Integrated Reporting Council
IR	Integrated Reporting
IV	Impact valuation
MCS	Multi-Capital Scorecard
O/Os	Obligation(s)
SA	Sustainability accounting
SASB	Sustainability Accounting Standards Board
SDG	Sustainable Development Goal
SEC	Securities and Exchange Commission (U.S.)
SN	Sustainability norm
TBL	Triple bottom line
U.S.	United States of America

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One of the ways of classifying indicators of organizational sustainability is to differentiate between those that may be universal in scope and others that are more organization-specific. The issue of materiality necessarily comes into play here, because even in cases where indicators are believed to be universal, their presumed status as such is just another way of saying that they are material to all organizations.

Not only are materiality determinations therefore necessary for purposes of identifying organization-specific indicators, they are also necessary for testing and evaluating the legitimacy of allegedly universal indicators. Thus, how best to perform or carry out such determinations is of vital importance to both types of indicators and to sustainability accounting in general.

1 Sustainability Accounting

Determining the materiality of sustainability indicators, or of the areas of impact (AOIs) they relate to, requires that we also differentiate between indicators of sustainability performance per se and those that express impacts in merely incremental terms. The first type, sustainability accounting (SA), assesses performance relative to sustainability norms; the second type, what we and others call impact valuation (IV), does not, and instead simply quantifies or values the magnitude of an impact independent of its sustainability.[1]

Impact valuation indicators are therefore merely incrementalist in the sense that they are used to assess the size and marginal change, if any, in the impacts from, say, one year to the next, often expressed in terms of their relationships with other variables – such as greenhouse gas emissions *per unit of revenue*, *per unit of production* or what have you. This is sometimes referred to as performance intensity.

Unlike IV indicators, SA indicators, by contrast, always express performance as impacts compared to a sustainability norm, which is what qualifies them as sustainability indicators. The most emblematic such indicators are *context-based metrics*, which express quantified comparisons between impacts and sustainability norms, usually in the form of a quotient.[2]

Typically, numerators in such quotients express the measured impacts of an organization in a particular AOI of interest, while the denominators express the corresponding sustainability norms (i.e., what the impacts would have to be in order to be sustainable, expressed in terms of organization-specific *thresholds and allocations*).[3] The resulting values can either be 1.0, less than 1.0, or greater than 1.0. For

[1] See McElroy 2017.
[2] For more on context-based metrics, see McElroy et al. 2006, McElroy 2008, and McElroy and van Engelen, 2012; see also "Context-Based Sustainability" on Wikipedia at: https://en.wikipedia.org/wiki/Context-Based_Sustainability.
[3] For an understanding of *thresholds and allocations* in this sense, see the related subsection on Wikipedia at: https://en.wikipedia.org/wiki/Context-Based_Sustainability

environmental AOIs, scores of ≤1.0 signify sustainable performance; for social or economic AOIs, the logic reverses and scores of ≥1.0 are sustainable.[4]

Because SA indicators express performance relative to sustainability norms, they are only used in cases where duties or obligations to perform in particular ways (i.e., norms) arguably exist. Organizations that emit greenhouse gases, for example, are ethically bound, most would say, to mitigate and ultimately eliminate their emissions in light of the negative effects they can have on the climate system and on human well-being as a result. Engaging in philanthropy, by contrast, would tend to be more discretionary and therefore less subject to sustainability norms.

What this means is that whereas SA indicators should always be used in cases where performance is being assessed relative to normative AOIs, IV indicators are under no such constraint. An IV indicator can be used for an AOI whether it corresponds to a duty or obligation or not. In no case, however, does an IV indicator actually express sustainability performance.

Materiality in the case of SA indicators, then, is contingent upon the determination of whether or not corresponding duties or obligations (Ds/Os) exist. In cases where impacts do in fact correspond to such Ds/Os, SA indicators must be used; in cases where they do not, IV indicators will do. Epistemology and value theory, in particular, therefore play a pivotal role in the making of materiality determinations for performance accounting in organizations and other human social systems. Performance, that is, relies on sustainability as its regulative ideal; and sustainability, in turn, is grounded in epistemology.[5]

2 Context-Based Materiality

With the above as background, the recommended materiality determination process set forth below is taken from a broader sustainability management methodology and doctrine known as Context-Based Sustainability (CBS).[6] The central tenet of CBS is that the sustainability performance of an organization is a function of what its impacts on vital capitals are relative to norms for what they would have to be in order to ensure human well-being. Organizations, in turn, can thereby be held to normative standards of performance for what their impacts on vital capitals must be in order to be considered sustainable.

Six types of capital are of particular relevance to integrated accounting at this time: natural, human, social and relationship, manufactured (also known as constructed or built), financial (or economic), and intellectual.[7] In some cases, intellectual capital is

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