MEMO

BSR

Materiality and Salience

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1. INTRODUCTION

This FAQ sets out the BSR perspective on the related concepts of materiality and salience. We believe that implementation of the key concepts described in this FAQ—such as double materiality, impact materiality, and salience—provide the foundation for more resilient business strategies, informed decision making by all stakeholders, and the realization of human rights in practice.

2. MATERIALITY

What is materiality?
Materiality is a foundational concept underpinning corporate disclosure.

The concept of "materiality" has its origins in the field of financial reporting, where it has referred to the disclosure of financial and non-financial information that is useful to the decision making of investors, lenders, and other creditors. These disclosures have generally been a legal requirement.

The term "materiality" was subsequently adopted by the field of sustainability[1] reporting, where it has referred to the disclosure of information that is useful to the decision making of a wider range of stakeholders, such as civil society organizations, policy makers, and communities. These disclosures have generally been a voluntary undertaking.

BSR typically uses the following two definitions of materiality in the context of sustainability disclosures, with the IFRS representing the investor-oriented test and GRI representing the wider stakeholder-oriented test:

- **IFRS Sustainability Disclosure Standard General Requirements (IFRS S1):** "Information is material if omitting, misstating, or obscuring that information could reasonably be expected to influence decisions that the primary users of general-purpose financial reporting make on the basis of those reports, which include financial statements and sustainability-related financial disclosures and which provide information about a specific reporting entity."
- **Global Reporting Initiative (GRI):** "Topics that represent an organization's most significant impacts on the economy, environment, and people, including impacts on their human rights."

[1] We define sustainability in its broadest sense, encompassing the economy, environment, and people, including social justice and human rights.

It is important to note that the IFRS definition is conceptually consistent with the SEC definition of materiality, which defines material issues as matters that “either individually or in the aggregate, are important to the fair representation of an entity’s financial condition and operational performance…[information that is] necessary for a reasonable investor to make informed investment decisions.”

BSR also utilizes definitions contained in the draft European Sustainability Reporting Standards (ESRS) being developed to accompany the new EU Corporate Sustainability Reporting Directive (CSRD). These are conceptually consistent with the IFRS and GRI definitions:

- **Financial materiality:** “A sustainability matter is material from a financial perspective if it triggers or could reasonably be expected to trigger material financial effects on the undertaking. This is the case when a sustainability matter generates or may generate risks or opportunities that have a material influence, or could reasonably be expected to have a material influence, on the undertaking’s development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term.
- **Impact materiality:** “A sustainability matter is material from an impact perspective when it pertains to the undertaking’s material actual or potential impacts on people or the environment over the short-, medium- or long-term…”

What is “double materiality”?

Over the past two decades the concept of “materiality” has suffered from being one term with two different definitions—the legal requirement to disclose information relevant for investors, and the voluntary expectation to disclose information relevant for a wider range of stakeholders.

The ESRS have introduced the concept of “double materiality”. This provides clarity that companies should report on matters that influence enterprise value (financial materiality) and matters that affect the economy, environment, and people (impact materiality).

Today BSR typically takes a “double materiality” approach by incorporating both dimensions into a single materiality assessment, with one axis in a 2x2 being dedicated to each dimension.

This is consistent with the notion that double materiality is the union of the two concepts in their totality, and not simply examining where they overlap—i.e., double materiality is using both concepts in combination, rather than only considering their intersection. A sustainability matter is “material” when it meets the criteria defined for impact materiality **or** financial materiality, or both.

We believe that “double materiality” supports conceptual clarity (i.e., that some information is required by investors to assess the creation of enterprise value, and some information is required by other stakeholders to assess broader impacts on society) and works with the grain of standards development (i.e., it encompasses both the IFRS Sustainability Disclosure Standards and GRI Sustainability Reporting Standards).

What is “impact materiality”?

The term “impact materiality” captures the notion that companies should understand the materiality of matters that affect the economy, environment, and people based on a company’s actual and potential impacts, rather than perceptions of what is important. The term “impact materiality” becoming increasingly common implies changes in how stakeholders are defined and how matters of importance are identified and prioritized.

In the past, materiality assessments often defined stakeholders as those whose judgments, decisions, and actions may be influenced by the company's sustainability disclosures; material matters were those that were "of interest" and "decision-useful" for report readers.

By contrast, "impact materiality" defines stakeholders as those that have an interest that is (or could be) affected by the company's activities and decisions, even if they are not users of a company's sustainability reporting. "Impact materiality" determines material issues based not on whether they are "of interest to stakeholders", but whether they "have an impact on the economy, environment, and people."

What are the practical implications of "impact materiality"?
There are two main implications: (1) which stakeholders are engaged with, and (2) the criteria used to prioritize sustainability matters.

First, it is important for the company to engage with all affected stakeholders to understand how they may be impacted by company activities, and not limit stakeholder engagement to just those who regularly interact with the company—for example, this may mean paying closer attention to rightsholders that do not buy or use a company's products, or to communities who may be impacted by infrastructure development.

Second, it means prioritizing impacts on the economy, environment, and people using the following criteria:

- **Scale:** How grave is the negative impact, or how beneficial the positive impact?
- **Scope:** How widespread would the positive or negative impacts be?
- **Remediability[2]:** Is it possible to counteract or make good the resulting harm (i.e., restoring the environment or affected people to their prior state)?
- **Likelihood:** What is the chance of the impact happening?

In practice, "impact materiality" means not asking stakeholders to "rank" how important they believe issues to be, and instead acknowledging that material impacts may not always be the most referenced concerns in stakeholder dialogue. Determining priorities is not a popularity contest.

What is "dynamic materiality"?
The concept of "dynamic materiality" captures the notion that the relative materiality of a sustainability matter may change over time.

One example is a sustainability issue initially being deemed as not having a material relevance for users of general-purpose financial reporting, but as having a material impact on the economy, environment, and people. Over time, this sustainability issue may become more material to users of general-purpose financial reporting, for example because of government regulation, evolutions in consumer sentiment, or changes in the operating context. The reverse can also happen if a sustainability matter is well managed by a company.

In this sense, the "impact materiality" component of "double materiality" can provide an early warning signal for what might become financially material later. It may also focus the attention of policy makers seeking to

[2] For negative impacts only

understand which sustainability matters are not material to enterprise value creation but are to society more broadly, and that therefore may benefit from greater regulatory attention.

BSR addresses “dynamic materiality” in part through our use of futures methodologies and scenario planning to identify how the materiality of issues may shift over time.

Do internal stakeholders have insights to offer on impact materiality?
Yes. In the past, materiality assessments often involved asking internal stakeholders which sustainability topics are most important for enterprise value creation and asking external stakeholders about which issues might influence their judgements and decisions.

However, internal stakeholders may have significant insights to offer on impacts on the economy, environment, and people—a product manager in a technology company may have insights into new product features that an external stakeholder would not, for example. The reverse can also be true, such as external stakeholders providing early insights into regulatory change or shifting consumer expectations.

Is anything changing in methods to assess “financial materiality”?
BSR anticipates greater discipline in assessing the impact of sustainability on enterprise value creation and enhanced alignment with enterprise risks management processes. For example, BSR’s methodology seeks to identify sustainability topics that may significantly affect enterprise value by influencing future cash flows or creating risks and opportunities for the company using an approach based on enterprise risk management, such as in our choice of assessment criteria. This might include:

- **Strategy and financials:** How significant is the impact on the company's ability to meet strategic and financial objectives?
- **Reputation:** How significant is the impact on the company's reputation?
- **Regulation:** How significant is the impact of the topic on the company's ability to comply with regulations?
- **Likelihood:** How likely is the impact to occur?

Further, it is important to note that, by focusing on enterprise value creation over the short, medium, and long term, the concept of financial materiality for sustainability reporting is different from the concept of materiality used in the process of determining which information should be included in a company’s financial statements.

Does BSR support use of the Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)?
Yes. BSR welcomes the fact that the ISSB and ESRS standards will build on existing frameworks and guidance, including the TCFD Recommendations and Climate Disclosure Standards Board (CDSB) Framework.

3. SALIENCE

What is salience?
Salience is a foundational concept underpinning how a company should prioritize action to avoid, prevent, and mitigate adverse human rights impacts.

While the concept of “materiality” has its origins in the field of reporting, the term “salience” has its origins in the field of human rights due diligence and the UN Guiding Principles on Business and Human Rights (UNGPs).

Salience refers to identifying, prioritizing, and addressing the company's most important adverse human rights impacts, with salience defined by the scale (how grave), scope (how widespread), irremediable character (how hard to make good) and likelihood of an adverse human rights impact.

What are the differences between impact materiality and salience?
Historically there have been two important differences to note between materiality and salience: (1) materiality is about disclosure, while salience is about management; (2) materiality covers all issues, whereas salience has been limited to human rights impacts.

Are the concepts of materiality and salience converging?
Yes, two significant developments are bringing the concepts of salience and materiality closer together.

First, the 2021 iteration of the GRI Sustainability Reporting Standards adopted a revised definition of materiality (see above) that incorporates the scope, scale, irremediable character, and likelihood definitions that underpin the concept of salience and the UNGPs.

Second, the ESRS also propose to adopt a definition of impact materiality based on the concept of salience and the UNGPs (i.e., scope, scale, remediability, likelihood). Further, the ESRS make clear that "the materiality assessment of a negative impact is informed by the due diligence process defined in the international instruments of the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises."

In short, the concept of salience is being utilized for disclosure (not just management) and for a comprehensive range of economic, environmental, and social issues (not just human rights). BSR welcomes these developments as enhancing conceptual clarity and generating synergy across previously siloed assessments.

Can a salience assessment be combined with a materiality assessment?
It depends. The harmonization of prioritization criteria between "salience" and "impact materiality" means that a salience assessment can be undertaken as part of a materiality assessment provided the expectations of a salience assessment are met—for example, that impacts on all potentially relevant human rights are considered and that affected stakeholders are engaged. BSR anticipates that this combined approach may become more common over time, especially for companies where salient human rights issues make up a large portion of material matters (e.g., social media companies).

However, we also expect that many companies will choose to keep these two assessments separate, while achieving efficiency, synergy, and harmonization by integrating the results of a salience assessment into a materiality assessment, rather than undertaking duplicative assessments.

4. TECHNICAL MATTERS

How often should materiality assessments be undertaken?
As a matter of principle, materiality assessments should be reviewed annually as part of the company's annual reporting cycle when deciding what information to disclose. However, a "full" materiality assessment with extensive stakeholder engagement may not be needed every year and should instead be prioritized to happen alongside major changes, such as mergers and acquisitions, market entry, or significant changes in operating context.

What is the threshold for determining materiality or salience?
Companies should define a cut-off point or threshold above which matters are considered material and / or salient. EFRAG's guidance on double materiality articulates five levels of impact and states that a topic is material if the assessment shows its impacts as being "critical", "significant" or "important" and not material if the impacts are deemed "informative" or "minimal". If a materiality threshold is met for either dimension of materiality (financial materiality or impact materiality), then the company should report on the topic. However, the "where and how" aspects for setting the threshold remains iup to the company's discretion, noting that (1) setting a threshold likely involves professional judgement rather than quantitative precision, and (2) materiality and salience are not absolute concepts, but relative to the other impacts the company has identified.

Should material or salient issues be further prioritized above a threshold?
In financial reporting a threshold-only approach is typically taken, meaning that all issues crossing a threshold of materiality are disclosed (e.g., risk factors in a Form 10-K), but with little attempt to further prioritize among material issues. By contrast, in sustainability reports many companies have chosen to publish 2x2 matrixes or other similar visuals to convey the relative prioritization of material matters.

BSR believes that either approach is legitimate, but we urge caution when conveying relative prioritization for two reasons: (1) a 2x2 matrix (or similar) can suggest significantly more quantitative precision in relative prioritization than is realistic; (2) a 2x2 matric (or similar) can suggest a collection of independent and mutually exclusive topics, whereas many material matters are interrelated, interdependent, and indivisible.

Should materiality and salience assessments cover a company's entire value chain, including both upstream and downstream?
Yes. The importance of taking a "whole value chain" approach is emphasized by both the ESRS and the UNGPs.

The ESRS state that "[material] impacts include those connected with the undertaking's own operations and value chain, including through its products and services, as well as through its business relationships. Business relationships include those in the undertaking's upstream and downstream value chain and are not limited to direct contractual relationships."

The UNGPs state that "the responsibility to respect human rights requires that business enterprises: (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur; (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts."

Is a materiality assessment required for sustainability strategy?
No. Many companies find it useful to undertake a materiality assessment as a step in the creation of strategy to help ensure that strategy focusses resources on the most important matters and set direction; however, materiality assessment is not a requirement for sustainability strategy, which can be undertaken separately from materiality.

Is a salience assessment required for human rights strategy?
Yes. The UNGPs are clear that companies have a responsibility to identify and assess any actual or potential adverse human rights impacts with which they may be involved and use this as the starting point for determining appropriate action to prevent and mitigate adverse human rights impacts.

Who should approve the final list of material topics or salient issues?
While third party organizations (such as BSR) may be actively involved in the materiality or salience assessment, as a matter of law and principle the final determination of material topics or salient issues should be made by the company. This determination should be made by the highest governance body in the company.

ABOUT BSR

BSR™ is an organization of sustainable business experts that works with its global network of the world's leading companies to build a just and sustainable world. With offices in Asia, Europe, and North America, BSR™ provides insight, advice, and collaborative initiatives to help you see a changing world more clearly, create long-term business value, and scale impact.

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