LODHA & CO

Primer on Materiality

March 2023

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THE CONCEPT OF MATERIALITY

Materiality assessment is the process of identifying, selecting, and evaluating a wide range of potential environmental, social, and governance concerns that may have an impact on your organization or your stakeholders, and then distilling them into a short list of subjects that guide firm strategy, targets, and reporting. The next generation of investors, the millennials, are concerned with making sure that their money is invested with an ESG focus, and 1 in 4 dollars are invested with ESG principles in mind. Due to this, investors are requesting more details from businesses regarding their sustainability initiatives. Due to this, investors are requesting more details from businesses regarding their sustainability initiatives. As a result, businesses will need to keep concentrating on determining their most important problems, coming up with solutions, and updating stakeholders on their progress. The concept of materiality helps you identify the social and environmental issues that are most important to your company and its stakeholders. About 80% of the top 250 firms in the world already mention significant sustainability challenges in their reporting. The study is primarily intended for risk managers, sustainability experts, and company report makers.

Businesses use the idea of materiality to guide their strategic planning efforts for sustainability. An economic, environmental, or social concern which affects or could affect a company is referred to as a material sustainability issue. It might also be one that has a big impact on stakeholders' views and decisions. While sustainability reporting is still voluntary, unlike financial reporting, and the overall process is mainly left up to the company, it is increasingly becoming a mandate for companies. It is considered best practice for a corporation to report on pertinent (or "material") concerns that could directly or indirectly affect how well it can produce, preserve, or degrade economic, environmental, and social value for itself, its stakeholders, the environment, and society at large.

The terms "materiality" as they relate to financial reporting and ";materiality" as they relate to sustainability reporting should be distinguished from one another. Information is regarded as material when it comes to financial reporting if its omission or inaccuracy could affect the economic decisions users make based on the financial statements (IASB Framework). Contrarily, in the context of sustainability, the term "materiality" refers to those challenges that may have a substantial impact on the business (both positive and negative).

An analysis of materiality cannot be done in a single approach. While some businesses manage the process internally, others with stronger sustainability teams rely on outside experts more frequently. Utilizing a third party expert can generally give the process more legitimacy and verify that the business is not just identifying its well-managed problems as the most important ones. Employing outside consultants can also assist in gathering stakeholder feedback because some stakeholders can be reluctant to communicate with the business directly, especially when it comes to sensitive issues.

ESG Materiality :

The threshold of ESG materiality, which is based on the financial notion of materiality, is the point at which ethical, social, or environmental topics are deemed relevant and substantial for the corporation to report.

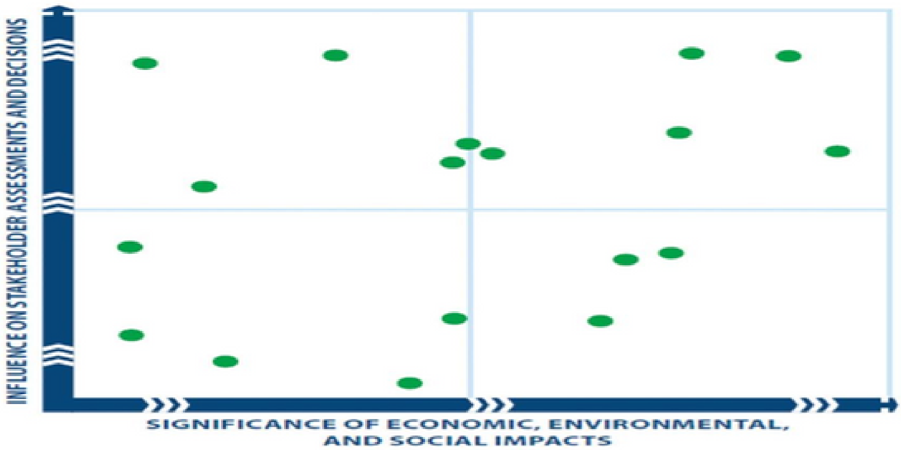
Financial Materiality :

Investors in companies typically pay attention to financial materiality, or problems that affect operating results and market value, and for regulators like the U.S. Financial materiality is a case of single materiality, with its single-minded focus on investors' interests in securing accurate financial

information. According to the Securities and Exchange Commission (SEC), information on a company is material and should be disclosed if a reasonable person would consider it [the information] important. It is now generally accepted that climate-related impacts on a corporation can be material and demand disclosure as a result of the work of organizations like the Task Force for Climate-Related Financial Disclosure (TCFD).

Double Materiality :

Not only investors are the focus; all stakeholders are as well. What matters are a company's broader effects or the economic, social, and environmental outcomes of its business operations. In this sense, materiality is more analogous to an externality and is associated with the effects of the business on all of its society stakeholders, both positively and negatively. The idea of double materiality is an extension of financial materiality, acknowledging that impacts on any aspect of sustainability, including economic, environmental, social, and governance-related concerns, as well as those related to climate change, may also have an impact on the organization. The European Commission originally presented the concept of " materiality" in 2019. By necessitating the inclusion of environmental, social, and financial material views in decision-making with careful analysis of their linkages, it broadens the concept of materiality to include acts from the inside-out and outside-in. Using a materiality matrix, double materiality is frequently used and most simply understood:



Source: GRI - Global Reporting Initiative

The following steps are often included in completing a materiality assessment:

- Determine the main concerns, classify them according to important stakeholder groups and business drivers.
- Obtain information from both internal and external stakeholders.
- Map out and prioritize the issues.
- Align the problems with the management and business goals
- Developing the strategy

Materiality Frameworks Overview

Companies employ a number of important frameworks to gain an understanding of the important materiality concerns that they need to take into account and report on. Each of the frameworks articulates the concept of materiality differently and serves a distinct purpose or audience. These organizations receive reports from a large number of companies. For instance, companies report to the UNGC or disclose information to CDP.

GRI: A "global independent standards organization that assists corporations, governments, and other organizations in understanding and communicating their impacts on topics including climate change, human rights, and corruption" according to GRI. The term "materiality" refers to issues that have a considerable impact on stakeholders' perceptions and decisions or to an organization's significant economic, environmental, and social impacts.

IIRC: The International Integrated Reporting Council (IIRC) is an international alliance of standard-setters, regulators, investors, businesses, accounting professionals, and NGOs. The group is advocating value creation communication as the following development in corporate reporting. Its goal is to make integrated reporting and thinking the standard in both the public and private sectors of business. If a problem has the potential to significantly affect how well an organization can produce value over the short, medium, and long terms, it is considered material. The method of figuring out materiality is entity-specific and depends on the industry, other variables, and viewpoints from multiple stakeholders.

SASB: In order to ensure that disclosure is meaningful, comparable, and useful for investors in making decisions, the Sustainability Accounting Guidelines Board establishes industry-specific standards for corporate sustainability disclosure. The SASB standards address sustainability issues that are anticipated to be important and to have a significant impact on the monetary health or operational efficiency of businesses within a certain sector. SASB uses the definition of "materiality" as it pertains to securities regulations in the United States for determining sustainability topics.

UN Global Compact (UNGC): Companies are urged by the UN Global Compact to agree to its sustainability principles in the areas of human rights, labor, the environment, and anti-corruption. It mandates that signatories create an annual communication on progress (COP) that details the advancements made in incorporating the 10 principles of the UNGC into operations and strategies.

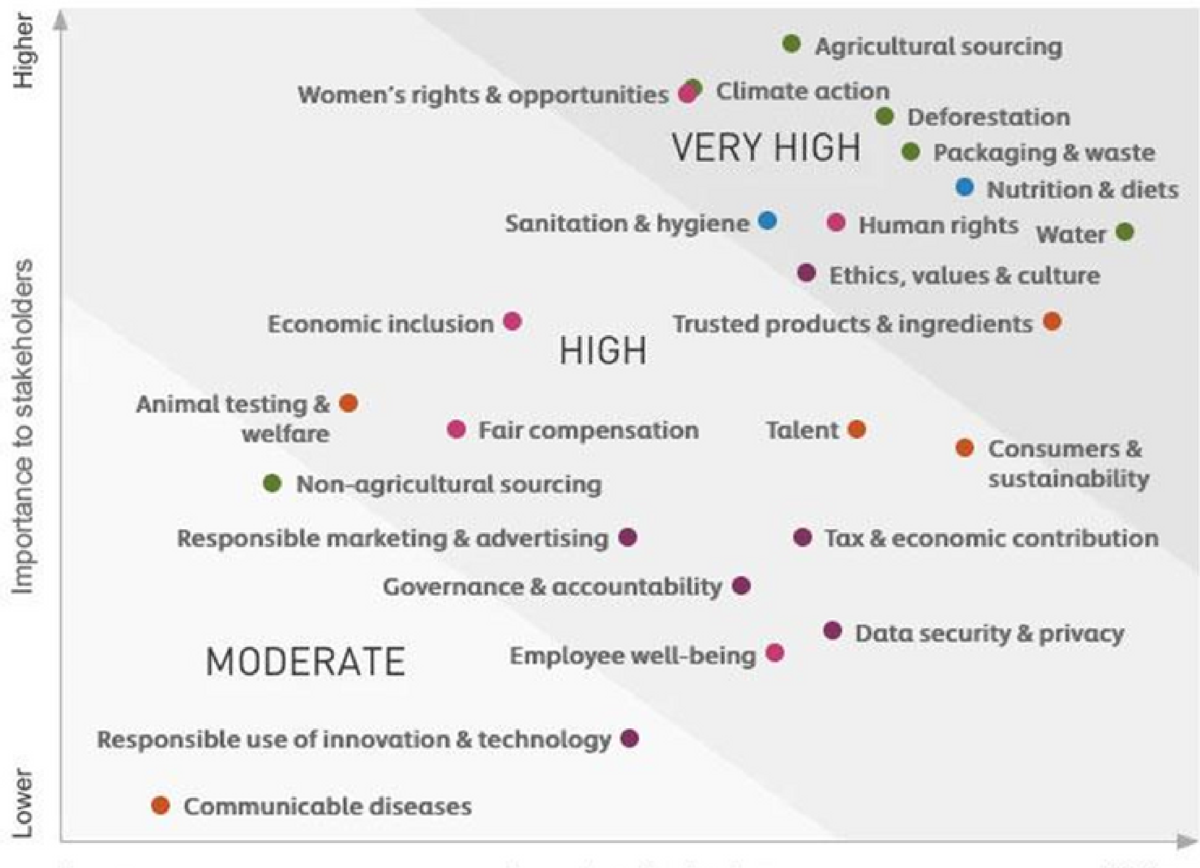
Setting and reporting sustainability and materiality goals will become more and more crucial. Companies are creating sustainability teams, emphasizing materiality, and publishing sustainability reports in increasing numbers. Analyzing which concerns need to be handled by businesses the most is called materiality. Potential sustainability issues that are believed to be directly related to an organization's value chain are identified, and then they are examined via two separate perspectives. Therefore, the organization needs to consider the following when considering topics like eliminating
plastic packaging, sharing wealth, or using sustainable suppliers:
1 What possibility exists for each issue to have an impact on organizational growth, cost, or trust?
2 The significance of each issue to the various parties. The end result is a visual representation of the issues that need to be prioritized based on how important they are to the success of the business and the expectations of its stakeholders (that can directly affect the first).
In other words, an environmental, social, and governance (ESG) study is a methodology a corporation can use to identify and quantify potential ESG that could have an influence on the business and its stakeholders.

Advantages of Conducting a Materiality Analysis

- It provides an opportunity to assess the risks and possibilities facing the company and, ultimately, to readjust and enhance their business strategy.
- It's an opportunity to identify areas where organizations are contributing to or detracting from societal value.
- It's a strategy for presenting top executives with a business case for why and how to publish ESG data.
- It offers the information and tools needed to evaluate various performances (financial, social and environmental)
- It automatically entails identifying trends and, hence, foreseeing new problems;
- Through evaluating the opportunities ahead, new products or services can be developed, helping businesses stay one step ahead of the competition.
- It allows companies to concentrate their efforts on improved resource allocation.
- Companies will be able to fulfill stakeholder expectations for sustainability reporting thanks to the analysis.
- It improves the probability of more effectively meeting the needs of stakeholders.

The conclusions and data from the materiality assessment can be utilized to develop ESG report content or for communications with certain stakeholder groups like investors, partners, consumers, or employees.

Example Of Materiality Analysis: A Materiality Matrix



An organization can select which sustainability concerns to concentrate on and devote effort to using a materiality analysis and the resulting materiality matrix, as indicated in the above graphic. By comparing two aspects, the materiality matrix illustrates these sustainability problems. One is the significance of the problem to the organization in terms of the predicted impact on the organization's success that this problem will have. The second is the significance or appeal of the issue to stakeholders and the likelihood that they will have an impact on business success as a result of the working efforts (or lack thereof) on this issue.

Growing Demand For Materiality Analysis

The science is clear: GHG emissions have been increasing for years, and they must begin to decline by 3.5% between 2020 and 2030 if we are to prevent an increase in global average temperature of more than 2°C before the end of the century. And the effects of the current rise in temperature are already being felt by cities that are flooding (like Venice), forests burning at a never-before-seen rate (like the forests in the Amazon and California), people dying from heat waves (like in India), and agricultural sites whose yields are declining.

People are speaking up to request or demand change as knowledge of these issues among the populace grows. Additionally, corporations, who are also being urged to exhibit greater openness and implement socially-just practices, are one of the actors from which they are expecting responses. According to several surveys, customers are increasingly choosing brands whose principles (and effective activities) coincide with their own. This is one of the reasons it is essential for businesses to adjust to stakeholder expectations, recognize their impact, and mitigate it if they want to survive over the long term.

Another argument is that internal hazards actually exist and must be taken into account. The ecosystem services, which depend on raw resources, are in danger as a result of rising temperatures, the destruction of reefs, and the extinction of 200 species of plants, insects, birds, and mammals per day. And for this reason, before making an investment decision, my investors are increasingly requesting ESG metrics and information from tools like materiality analysis.

Conclusion

By recognizing, choosing, and prioritizing sustainability issues with significant implications, the concept of materiality, which has its roots in the context of financial reporting, has been applied in and contributed to sustainability reporting. The materiality approach has advantages over the traditional stakeholder approach, which attempts to meet the information demands of all stakeholders but faces two conflicts: the data sea and stakeholder requirements, and selective reporting and automated reporting. By acting as a filter to the data sea while pleasing important stakeholders and offering a balance on selective reporting and mechanized reporting, materiality resolves the two main problems.

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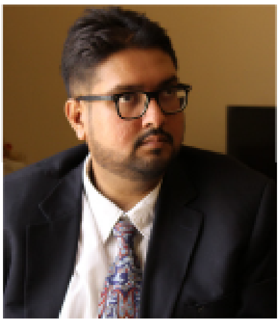

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