The Materiality Bridge

New research on how companies are spanning the strategy-sustainability divide

For the second consecutive year, Framework has conducted research into the uptake of materiality analysis among companies recognized as sustainability leaders.

What is the purpose of the research?

Companies are seeking to be more strategic in their efforts to become more sustainable organizations. They want to know what issues are most important for them to focus on, from the perspective of facilitating the achievement of business goals as well as meeting the needs of various stakeholder groups.

The use of materiality as a tool to determine the importance of business issues has been in use in financial planning and analysis for many years. Materiality analysis could therefore be presumed to have similar utility for companies weighing the potential impact of environmental, social, governance, and economic issues—the full spectrum of concerns faced by modern corporations. Similarly, as the concept of integrated sustainability and financial reporting evolves and gains currency, companies could be expected to begin extending the tools of financial analysis to sustainability disclosure in an effort to meld the two together.

We initiated our research to see whether these hypotheses would hold true. We asked: are sustainability leaders in fact taking advantage of materiality analysis as a tool to support strategy setting and reporting?

What companies did you evaluate?

We used the CR Magazine's *100 Best Corporate Citizens* lists of 2010 and 2011 as the basis for our research. This ranking comprises a convenient subset of companies recognized for leadership in sustainability performance and disclosure. We did not align any of the research to CR Magazine's specific ranking methodology, nor did we attempt to draw any conclusions as to the relative merits of this list as compared with other sustainability ratings, rankings, awards, or recognitions.

For each company, we identified the most recent sustainability publication, website, or microsite that could be interpreted as a "sustainability report". We realize that companies publish reports on different cycles, so our research may reference different report years for different companies. Also, new reports may have been issued in the period between when we evaluated a report and when we published research results. Finally, because some companies are on a two-year reporting cycle, or may not have issued a new report in time to be considered in our current research cycle, some information may have been duplicated from year to year. For example, of the 83 companies appearing on both the 2010 and 2011 *100 Best* lists, only 52 companies released new reports in the period between the 2010 and 2011 research.

Similarly, we evaluated the most recent 10-K financial filings for each company in the study as of the date the research was conducted. We did not interview or otherwise engage with companies directly.

In what time period was the research conducted?

First research cycle (2010 *100 Best* list): September 1, 2010 to January 30, 2011

Second research cycle (2011 *100 Best* list): June 27, 2010 and August 9, 2011

What specific data points did you collect?

We evaluated each company's disclosures with the following questions in mind:

1. Did the company conduct a formal process—a materiality analysis—to identify and prioritize its sustainability issues?
2. Was this process described in detail? For example, what steps did the company take to identify issues, gather stakeholder input, and evaluate the potential impact of specific issues on company performance?
3. Did the company provide a visual representation (matrix, chart, diagram) of the results of the materiality analysis?
4. Were the results of the materiality analysis clearly brought to bear on the structure of the report, selection of key topics, narrative emphasis, provision of data and indicators, and/or definition of goals and targets?
5. Were sustainability issues (including those defined as "material") reflected in the risk factors section of the company's 10-K annual financial filings?
6. Did the company use the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines? If so, what application level did the company declare?

What parameters did you use in evaluating company disclosures?

In each company's sustainability report, we looked for explicit evidence that the company had conducted a rigorous, methodical, and thorough analysis of its sustainability issues—a **materiality analysis**. A simple reference to materiality with no further explanation of process didn't make the cut, nor did an enumeration of a huge swath of general topics as "material".

If a materiality analysis was conducted in a prior reporting year, then we gave the company credit for a materiality analysis as long as the results from the previous analysis remained relevant. We adopted this approach because the shelf-life of a materiality analysis extends past a single reporting year. Depending on the industry and how quickly priorities change, a full materiality analysis could reasonably be conducted every 2 to 4 years.

Companies were given credit for a **materiality process description** when the company demonstrated that a materiality analysis took place and provided an explicit overview of the process.

Companies were given credit for **applying the results** of their materiality analysis when we could discern visible evidence of identified material issues in reporting highlights, metrics or targets, or other emphasis in the narratives.

What did you look for in companies' financial filings?

Companies were given credit for addressing sustainability issues within their 10-K annual financial filings (whether or not they had performed a materiality analysis). We focused mainly on the following sections of financial reports:

- Item 1- Business
- Item 1A- Risk Factors
- Item 7- Management's discussion and analysis of financial condition and results of operation

If the 10-K referred to the annual report for more information about a specific topic, then we also used the annual report in our evaluation.

In reviewing these documents, we recognized companies for including "non-standard" environmental, social, and governance issues in their disclosures. We used a subjective four-point scale to answer the following question:

Does the 10-K incorporate sustainability issues relevant to a company's business objectives and stakeholder concerns:

1. *To a large degree*
2. *Somewhat*
3. *Minimally*
4. *Not at all*

Where can I get more information about this research?

The full research results are available on our website, www.frameworkcr.com. We will continue to post analysis of results along with expert commentary in the coming weeks. Please feel free to join the conversation!

For specific question on outcomes or methodology, please contact:

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