

## Determining Key Material Matters In Sustainability Reporting: Does Industry Types Matter?

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### Abstract

*With the additional demand for companies to also provide sustainability reports, corporate reporting has becoming overwhelming in quantity and do not necessary help stakeholders understand the business performance. This lead to the need for companies to conduct a materiality assessment for their sustainability report. Malaysia, in particular, has introduced a revised 2018 Sustainability Reporting Guide, which include a materiality matrix that helps companies prioritize their material sustainability matters. Despite the growing importance of materiality assessment in sustainability reporting, little is known on the extent of materiality assessment practice among Malaysian companies. This study aims to provide a preliminary analysis on key matters that are commonly considered as material by top 50 Malaysian public listed companies and examine whether industry types play a significant role in differentiating the amount/category of key material matters identified. By content analyzing the top 50 companies' 2018 corporate report ranging from annual reports to stand-alone reports, the findings show each company has identified, on average, 16 matters that are considered as key to their sustainability. The findings also show the most prioritize matter in the assessment is under the category 'Social' with each company identified, on average, 6 social related matters. Based on the Kruskal Wallis test, there seem to be no significant difference, in the total number of key material matters identified, between companies from different types of industry. However, a much detail analysis on category of key material matters show there is a significant difference between companies from different types of industry when it comes to matters under the category 'Economic'. The other three categories i.e. environment, governance and social do not have any significant difference. Findings from this study are considered as crucial as it provide initial understanding on Malaysian companies' behavior in determining matters that is considered as material to their sustainability.*

**Keywords:** Materiality, Sustainability, Reporting, Industry

### Introduction

Materiality is one of the fundamental accounting concepts where the discussion on its definitive definition and application has constantly avoid the attention of financial reporting players (Messier, Bennie & Eilifsen, 2005). Despite issues surrounding its definition and application, the International Accounting Standard Board (IASB) has come up with the following definition of materiality:

“information is material if omitting it or misstating it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity (IASB, 2015 pg. 7)”

In other words, materiality is an entity-based concept where its relevance is determined based on the magnitude of which the information, item or transaction matters to the companies' operation and their shareholders' decision making process.

Brennan and Gray (2005) assert that while companies are required to disclose a true and fair view in law, materiality allows some degree of flexibility reflected through the professional judgment that need to be used. While the judgment may seem necessary as it represent a range of factors and entity-specific circumstances, it could potentially lead to disclosure ineffectiveness. As highlighted in the Ernst and Young (EY) 2015's report, disclosure ineffectiveness resulted from poor application of

materiality could contribute to (1) not enough relevant information; (2) too much irrelevant information; and (3) poor communication of information in the financial statement (EY, 2015).

Adding to the complexity of materiality in corporate reporting, the concept is now being extended to the issue of sustainability. There has been a growing need for companies to also provide information on how its operation affect wide array of sustainability issues ranging from economic, social, environmental to governance. Some countries, including Malaysia, have made it compulsory for their public listed companies to provide report pertaining to the sustainability issues. The growing popularity of sustainability reporting could potentially resulted in overwhelming quantity of information being reported and do not necessarily help stakeholders understand the business performance. As a result, companies are now being bequeathed with responsibility to conduct a comprehensive materiality assessment of their sustainability impact, incorporating stakeholder engagement into the process (Puroila&Makela, 2019).

Recognizing the needs to conduct materiality assessment in sustainability reporting, Malaysia, in particular, has launched a revised version of its Sustainability Reporting Guide in year 2018 which include a materiality assessment toolkit that can help companies determine which non-financial information considers as material within the context of companies' stakeholders' needs. With materiality being imposed as one of the elements that need to be incorporated in the corporate report, it is no surprise the issues has started to gain attention of the research community. Much of the literature, however, have explored the issue of materiality within the context of general financial reporting or auditing with little attention being given on its application in sustainability reporting. With sustainability taking a more significant role in corporate reporting and the fact that little attention has been given by research community, the following two research questions are raised in this present study:

RQ1: What are key material matters identified by top Malaysian public listed companies in their materiality assessment?

RQ2: Do types of industry plays a significant role in differentiating the amount/category of key material matters identified by companies?

## **Literature Review**

### ***General Concept of Materiality***

Traditionally, materiality is one of the accounting concepts where its application is considered as crucial in helping accounting practitioners prepare or assess corporate financial performance. Its application starts with companies' management who uses their judgement to make decision which information is material in preparing their financial statement followed by auditors who will then make independent decision on whether or not true and fair view is presented in the financial statement (Gray& Manson, 2008). With issues surrounding how materiality assessment are made, it is no surprise that the concept has attracted lots of research interest. To date, there has been a number of researchers sought to provide more insight on what is materiality and how it should be applied. Brennan and Gray (2005), for example, conduct a review of literature on accounting materiality and examine the context in which materiality is relevant as well as problems arising from applying the concept in practice. Their findings have called on regulators to extend disclosure requirement to include information about materiality levels to enhance transparency of accounting and auditing.

It is also noticeable that a large stream of research has put more focus on querying the circumstances of auditor materiality judgments particularly those looking at cues and factors influencing decisions on what is considered as material or immaterial (see for example Messier et al, 2005;Nelson, Palmrose& Smith, 2005).Messier et al (2005) note that findings from past researches on audit materiality have led to several apparent theme. First, materiality was commonly decided based on how large the size of an item is represented through the companies' net profit. Second, judgement made by financial reporting players is largely influenced by qualitative factors particularly their experience. Lastly, it is expected that materiality judgments made by different types of financial reporting players vary depending on their specific needs (Messier et al, 2005).

With each heterogeneous group (management, auditors, and users) demonstrates different threshold because of their divergent motivations (Messier et al, 2005) and could be affected by different factors in making their materiality decision, it lead to an apparent need for a guideline to close the gap between what is expected by the regulators and what is currently being practiced. This

complexity surrounding the issue of materiality in traditional financial reporting is further increased with the need for companies to provide a report on their sustainability impact. Once again, materiality has been highlighted as one of the concepts that need to be highlighted by companies when preparing their sustainability report to avoid overloading of information that could eventually effect stakeholders' decision making process.

### ***Materiality in Sustainability Reporting***

With sustainability consistently being highlighted as one of the issues that need to be incorporated in companies' operation, there has been growing numbers of companies that publicly publish their sustainability strategies and achievements (Jones, Hillier & Comfort, 2016a). However, with the growing concern on sustainability related issue, sustainability information has becoming more complex leading to the need to incorporate a much broader approach in assessing the timescales and stakeholder interests (Accountability, 2006). Therefore, there is a need for the business community to not only embrace materiality, starting with the identification of issues related to environmental, social and economic that they consider as pertinent to the companies' operation and their stakeholders but to also appoint external independent assurance that can provide assurance on the reliability of the information contained in such reports (Jones et al, 2016a).

Despite the increasing interest in materiality within the setting of sustainability reporting, to the knowledge of this present study, there has been lack of empirical studies being conducted looking at the application of materiality within the setting of sustainability reporting. It is notable, however, that recent studies have started to address the concern on the subjective nature of materiality in assessing companies sustainability impact by proposing method or guideline that can help to minimize the subjectivity involve in its application. Calabrese, Costa, Levialdi and Menichini(2016), for example, propose a 'fuzzy analytic hierarchy process' method to assist sustainability reporting by using a structured materiality analysis developed based on the Global Reporting Initiative Guidelines. The authors expect that through the process, a set of prioritized sustainability indicators will be identified which can then help companies to prepare their reports. In another study conducted by Hsu, Lee and Chao (2013), failure modes and effects analysis is utilized to construct a model of materiality analysis for determining material issues to be included in sustainability reporting for Lite-On Technology Corporation in Taiwan.

Recently, country and specific based studies has started to gain the attention of research community with much of the studies focus on European countries (see for example Jones, Comfort & Hillier (2015), Jones et al, 2016a; Jones et al, 2016b; Torelli, Balluchi & Furlotti, 2019). Jones et al (2015), for example, conduct a preliminary analysis on the extent to which the UK's leading commercial property companies are utilizing the concept of materiality and sought the service of independent external assurance in their sustainability reporting process. Their findings reveal approximately half of the UK's leading property companies had embraced materiality or commissioned some form of independent external assurance as an integral part of their sustainability reporting processes.

Despite the growing interest in materiality-based study, it is notable that research conducted in the area of materiality in sustainability reporting is still lacking. In the case of Malaysia, in particular, there has been very little evidence found by this present study on research conducted in the area of materiality. With sustainability and materiality taking a much significant role in corporate reporting, it is the objective of this study to evaluate key material matters identified by top Malaysian public listed companies in their materiality assessment. Additionally, this study will provide evidence on whether or not types of industry play a significant role in differentiating the amount/category of key material matters identified by companies.

### **Research Methodology**

To achieve the objectives of this study, materiality assessment analysis focuses on only top 50 Malaysian public listed. The top 50 companies are determined based on their disclosure ranking. Only top 50 Malaysian companies, by disclosure, are chosen as these are companies that has been ranked by Minority Shareholders Watch Group (MSWG) Malaysia as top ranking when it comes to

disclosure for year 2017. The list is taken from year 2017 as this is latest list produced by MSWG at the time the study is conducted.

For the selected 50 companies, content analysis is conducted on the companies' annual reports for year 2018. In the case where the company also produces a stand-alone sustainability report for year 2018, those reports are also examined. It is pertinent to analyse both reports as at present it is not compulsory for Malaysian public listed companies to produce a stand-alone report. This means information on materiality in sustainability reporting can be found either in one of the reports or both. With regard to types of industry, the 50 companies were categorized based on the following categorization provided by Bloomberg.

Table 1:List of Industry Types

Industry Types	Frequency	Percent
Financial (Code:1)	18	36.0
Communication (Code:2)	6	12.0
Energy/Utilities (Code:3)	6	12.0
Consumer Products (Code:4)	6	12.0
Industrials (Code:5)	11	22.0
Healthcare (Code: 6)	3	6.0
Total	50	100.0

Table 1 provides a summary of companies based on their industry types. From the 50 companies, 18 companies falls under Financial while Utilities/Energy, Communications and Consumer Products consist of 6 companies each. The second largest number of companies are under Industrials/Materials with 11 companies. The least number of companies is under the category Healthcare with only 3 companies.

In content analysing the report, this study utilizes the key words 'material', 'materiality', 'matrix', and 'sustainability'. Once the section on companies' materiality assessment is found, a list of key material matters are identified from that particular section.

Each key material matter is then categorized under four categories namely, economy, environment, social and governance. It is notable that most of the companies have already categorized each of their materials under respective category. In the case where the categorization is not available or the companies use different types of categorization, the researchers have used their own judgement in categorizing the key material matters into the respective four categories.

## Findings

Table 2 shows the distribution of the key material matters identified in the 50 Malaysian public listed companies' reports, in total as well as by categories. Based on the result, a total of 781 key material matters have been identified as material by the 50 companies with the lowest number of key material matters is 5 while there are also companies who identified up to 35 key material matters in their materiality assessment. Further analysis on the identified key material matters, by category, shows that sustainability category with highest number of key material matters is 'Social' (319) and category that recorded the lowest number of key material matters is 'Governance' (75).

In describing the result based on the four sustainability categories, it is notable that there were companies who did not identified any key material matters under the category 'Economy', 'Environment' and 'Governance' while all companies seem to recognize 'Social' as one of their key material matters. One company has even recognized up to 19 key material matters related to 'Social'. 'Environment' has been recorded as the second highest number of key material matters being recorded by a company followed by 'Governance' and 'Environment'.

Table 2: Distribution of Key Material Matters by Category

	<b>N</b>	<b>Min.</b>	<b>Max.</b>	<b>Sum</b>	<b>Mean</b>
Total Key Material Matters	50	5.00	34.00	781.00	15.62
Economics	50	0.00	14.00	242.00	4.84
Environment	50	0.00	7.00	146.00	2.92
Governance	50	0.00	12.00	75.00	1.50
Social	50	1.00	19.00	319.00	6.38
Valid N (listwise)	50				

Table 3 and 4 show the results for a non-parametric kruskallwallis test conducted on the key material matters (in total and by categories) and the types of industry with Table 3 showing the mean rank for each industry and Table 4 showing the result for the test of difference. As highlighted in the literature review section, the objective is to see whether types of industry play a significant role in differentiating the amount/category of key material matters identified by companies. Kruskallwallis test is one of the most common test that can be used to achieve this objective. Based on figures in Table 3, it can be highlighted that Industrial scores the highest mean rank for total key material matters disclosed as well as material matters under the category ‘Environment’. In the case of ‘Economics’ and ‘Social’, Communication scores the highest mean while Consumer Products scores the highest mean for the category ‘Governance’.

When determining whether or not there is significant difference between different types of industry, Table 4 tabulates that there is a statistically significance difference ( $p=0.015$ ) in the number of key material matters identified under the category ‘Economy’. This indicate differences across different types of industry when it comes to identifying matters under the category ‘Economy’. In the case of total number of key material matters, there seem to be no significant difference between companies from different types of industry. The same goes to the other three categories namely ‘Environment’, ‘Social’ and ‘Governance’. This shows that while it is normally expected certain industries to identify more material matters under certain categories, except for economy, the results are showing otherwise. For example, it is expected that a more environmentally sensitive industry such as Energy/Utilities to significantly identify more key matters under the category ‘Environment’, the result shows regardless of the industry, number of key material matters for ‘Environment’ is the same.

Table 3: Distribution of Key Material Matters by Category

<b>Sector</b>	<b>N</b>	<b>Mean Rank</b>
Total	1.00	18
	2.00	6
	3.00	6
	4.00	6
	5.00	11
	6.00	3
	Total	50
Economics	1.00	18
	2.00	6
	3.00	6
	4.00	6
	5.00	11
	6.00	3
Environment	1.00	18
	2.00	6
	3.00	6
	4.00	6

	5.00	11	34.23
	6.00	3	28.17
	<b>Total</b>	<b>50</b>	
<b>Governance</b>	1.00	18	28.08
	2.00	6	26.00
	3.00	6	26.00
	4.00	6	29.75
	5.00	11	17.45
	6.00	3	29.00
	<b>Total</b>	<b>50</b>	
<b>Social</b>	1.00	18	21.17
	2.00	6	30.42
	3.00	6	30.33
	4.00	6	20.83
	5.00	11	29.59
	6.00	3	26.33
	<b>Total</b>	<b>50</b>	

Table 4: Kruskal Wallis Test Statistics

	<b>Total</b>	<b>Econ.</b>	<b>Envi.</b>	<b>Governance</b>	<b>Social</b>
Chi-Square	4.873	14.175	6.530	5.094	4.484
df	5	5	5	5	5
Asymp. Sig.	0.432	0.015	0.258	0.405	0.482

Taking into consideration the significant difference between different types of industry for key material matters under the category ‘Economics’, a post hoc test of kruskallwallis is conducted to see where the difference lies. As illustrated in Table 5, a pairwise comparison between the six different types of industry shows a significant difference between Industry 4 (Consumer Product) and 5 (Industrial) as well as between Industry 4 (Consumer Products) and 2 (Communications). This provides an indication that as compared to the consumer product industry, industrial and communication industries are recognizing significantly more material matters related to ‘Economics’.

Table 5: A Post Hoc Test of Kruskall Wallis

Sample 1-Sample 2	Test Statistic	Std. Error	Std. Test Statistic	Sig.	Adj. Sig. <sup>a</sup>
4.00-3.00	9.167	8.364	1.096	0.273	1.000
4.00-1.00	19.111	6.829	2.798	0.005	0.077
4.00-5.00	-22.159	7.353	-3.014	0.003	0.039*
4.00-6.00	-23.083	10.244	-2.253	0.024	0.364
4.00-2.00	25.083	8.364	2.999	0.003	0.041*
3.00-1.00	9.944	6.829	1.456	0.145	1.000
3.00-5.00	-12.992	7.353	-1.767	0.077	1.000
3.00-6.00	-13.917	10.244	-1.358	0.174	1.000
3.00-2.00	15.917	8.364	1.903	0.057	0.856
1.00-5.00	-3.048	5.544	-0.550	0.583	1.000
1.00-6.00	-3.972	9.035	-0.440	0.660	1.000
1.00-2.00	-5.972	6.829	-0.874	0.382	1.000
5.00-6.00	-0.924	9.436	-0.098	0.922	1.000
5.00-2.00	2.924	7.353	0.398	0.691	1.000
6.00-2.00	2.000	10.244	0.195	0.845	1.000

## Conclusion

The objectives of this paper is to provide an analysis on the key material matters identified by top 50 Malaysian public listed companies, by disclosure, and to see whether types of industry play a significant role in differentiating the amount/category of key material matters identified by Malaysian companies. The findings show a total 781 key material matters identified by the 50 companies with ‘Social’ showing the largest number of key material matters being identified as compared to the other three categories namely ‘Economic’, ‘Environment’ and ‘Governance’. While it is expected there is significant difference, in terms of number of key material matters being identified, across different types of industry, the kruskallwallis test has shown that only ‘Economic’ shows a significant difference. The remaining three categories remain insignificant. This shows that regardless of types of industry, all industry consider matters under ‘Social’, ‘Environment’ and ‘Governance’ as equally important.

This paper contributes in terms of issue being raised and the literature. With materiality in sustainability reporting gaining more attention from the regulators and the fact that previous studies have focused more on the general issue of sustainability reporting, a study on the application of materiality in sustainability reporting is considered as timely. In the case of Malaysia, particularly, materiality assessment has been embedded as part of the Bursa Malaysia Sustainability Reporting Guide 2018 providing an indication that the regulators do consider materiality assessment as one of the critical components in sustainability reporting. Therefore, a research in this area is considered as a new contribution in the sustainability-based research particularly within the setting of Malaysian companies. Additionally, findings from this present study provide an up-to-date discussion to the existing sustainability as well as materiality literature. While it is notable that this is only an exploratory and descriptive study, the findings do provide more insight on the extent of which Malaysian companies consider sustainability related matters as material to their companies’ operation.

There are some limitation to this paper. First, the use of content analysis may impose limitation as this method requires judgment by the researchers. While the researchers have taken measures to ensure objective assessment is made there is no denial that content analysis depend highly on the researchers own judgement. Therefore, there is always a possibility that if different researchers come in, that particular researchers may have come up with different findings. Secondly, with only 50 companies, the sample size may not be sufficient to generalize the findings to all public listed companies in Malaysia. Nonetheless, it is notable that the findings do provide some insight on how Malaysian companies determined their materiality in sustainability reporting.

Future research on materiality within the context of sustainability could strengthen the analysis with a more comprehensive empirical testing by introducing more factors that could influence companies’ materiality assessment of their sustainability impact. The sample size can also be increase with the possibility of making an international comparison with companies from other countries. Additionally, the focus so far is on secondary data i.e. materiality information reported in the companies’ corporate report. The method can be extended to primary data by directly obtaining the view of corporate reports’ preparers on why they decide to focus on certain key material matters as compared to others.

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#### **Author's contribution**

Mat Husin carried out the main research works starting from conceptualising the research idea up to the final write up of the paper. Alrazi contributes mainly in refining the research idea as well as data analysis. Mohd Salleh and Abdullah contributes largely in the collection of the data and any administrative tasks related to the paper submission.

#### **Conflict of Interest Statement**

The authors agree that this research was conducted in the absence of any self-benefits, commercial or financial conflicts and declare absence of conflicting interests with the funders.

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