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The adoption of the materiality concept in social and environmental reporting assurance: A field study approach

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ABSTRACT

This study investigates the logics or values that shape the social and environmental reporting (SER) and SER assurance (SERA) process. The influence of logics is observed through a study of the conceptualisation and operationalisation of the materiality concept by accounting and non-accounting assurors and their assurance statements. We gathered qualitative data from interviews with both accounting and non-accounting assurors. We analysed the interplay between old and new logics that are shaping materiality as a reporting concept in SER. SER is a rich field in which to study the dynamics of change because it is a voluntary, unregulated, qualitative reporting arena. It has a broad, stakeholder audience, where accounting and non-accounting organisations are in competition. There are three key findings. First, the introduction of a new, stakeholder logic has significantly changed the meaning and role of materiality. Second, a more versatile, performative, social understanding of materiality was portrayed by assurors, with a forward-looking rather than a historic focus. Third, competing logics have encouraged different beliefs about materiality, and practices, to develop. This influenced the way assurors theorised the concept and interpreted outcomes. A patchwork of localised understandings of materiality is developing. Policy implications both in SERA and also in financial audit are explored.

1. Introduction

This paper investigates the logics or values that shape the social and environmental reporting assurance (SERA) process conducted by accounting and non-accounting assurors. Nearly 95 percent of the largest 250 companies worldwide issue social and environmental reports (SER), of which 46 percent are independently assured (KPMG, 2011). Moreover, SER is increasingly important to stakeholders and institutional investors (Solomon, 2013). The influence of logics is observed through a study of the conceptualisation and operationalisation of the materiality concept, and assurance reports issued by accounting and non-accounting assurors. We focus on materiality because it is an iconic reporting concept associated with the fair representation of data.[1]

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In financial reporting, materiality is a "cornerstone" concept (Lee, 1984) that determines the importance of an item for information users (FASB, 1975). By law, companies are required to show a true and fair view in their financial statements, but the precise meaning of this term is unclear. Materiality complements this fuzzy requirement. It determines important errors or omissions in data but allows a tolerable degree of flexibility in judgments (Brennan & Gray, 2005).

Our study is concerned with the adoption of materiality as a key reporting principle in SER and SERA. New guidance has extended the concept, beyond financial impacts, to the significant social and environmental impacts of corporate performance for a stakeholder audience (AccountAbility, 2003). Material disclosures might include corporate water and energy usage, CO_2 emissions, the environmental impacts of production, fair trade, employee working conditions, workplace diversity, safety technology or areas of stakeholder activism. Material information helps stakeholders to make effective decisions (AccountAbility, 2006a, 2006b).

This redefinition of materiality raises important research questions about assuror judgements in SERA. Why has a core concept, linked to economic decision-making, been adopted in a new reporting field that places corporate social responsibility at its heart? Is the concept of materiality relevant to SER and if so, how? How is materiality in SER different compared to financial reporting? What rationales underpin the concept? How has materiality been adapted to SER? We seek to address these questions and add to our knowledge about the values that underpin materiality and shape SERA.

This study draws upon insights from neo-institutional theory and institutional logics. Logics are deep principles that underpin behaviours within institutional fields. They prescribe social "assumptions and values" (Thornton, 2004, p.7) and frame the way individuals make sense of reality. Logics provide a useful lens for investigating changes in ideas and practices (Friedland & Alford, 1991). An analysis of the interplay between logics can explain how and why practices change (Lounsbury, 2008). Further work on logics has been called for, in accounting, to understand the dynamics of change in practices (Lounsbury, 2008).

The operationalisation of accounting materiality has been shaped by two traditional logics: a market logic (for the benefit of shareholders) and a professional logic that underpins financial audit. Its adoption into SER has introduced a new, stakeholder logic into its meaning for the benefit of a wide audience. A logics approach is relevant to our study because SER provides a rich context for analysing the interplay between old and new logics in redefining materiality. First, the unregulated status of SER allows non-accounting stakeholder organisations (the Global Reporting Initiative (GRI) and AccountAbility) as well as accounting bodies (such as the International Federation of Accountants, IFAC) to provide reporting guidance. Second, both professional accounting and non-accounting firms compete to provide SERA in this voluntary market. Differences in beliefs between these two assuror groups have already been observed (O'Dwyer & Owen, 2005). Third, SER comprises softer, qualitative data and lacks helpful benchmarks, such as net profit, to guide materiality decision-making. SER materiality decisions are more subjective. Fourth, boundaries and relationships between organisations in SER are still in a state of flux (Etzion & Ferraro, 2010).

This new institutional environment creates potential tensions between logics. Materiality is a malleable concept (Edgley, 2014) and assuror beliefs may reflect different logics. Although a stakeholder logic is likely to be common amongst all assurors (because SER operates for a stakeholder audience), we anticipate that points of divergence in logics are likely to be observed between these assuror groups. Hybrid-logics may be evolving. The understanding of materiality amongst non-accounting organisations in SER (often from an engineering or consultancy background) is not constrained by professional regulation. Their expertise is in assessing risk from an environmental and community perspective. They are influenced by a strong commercial logic in seeking to establish themselves in a new field. Accounting assurors, by contrast, must adhere to professional guidance in their understanding of materiality. They are likely to be blending traditional logics that have shaped accounting materiality with a new stakeholder logic in SER. Their expertise is in assessing financial impacts for shareholders. We suggest that these logics compete and shape understandings of materiality differently. We evaluate the consequences for information users.

This paper has three objectives. First, we examine how assurors make sense of materiality in SER and the extent to which this differs from financial audit materiality. We investigate how assurors have accommodated a new stakeholder logic when traditionally materiality has been structured by a market and professional logic for shareholders. Second, we examine the adaptation of materiality and beliefs that underpin new practices and technologies. We question whether competing logics encourage variations in practices to develop (Lounsbury, 2008). Third, we explore how assurors theorise materiality as an emerging area of expertise in SER and SERA. We query how competing logics may influence beliefs about the outcome of materiality practices.

Our study used qualitative interview data from both accounting and non-accounting assurors and sources of professional guidance to explore materiality. We focus on assurors because, although management initially make materiality decisions, more independent decisions are made by external assurors (Gray & Manson, 2008).[2] An interview approach was consistent with calls by O'Dwyer and Owen (2005) and Parker (2005) for more SER fieldwork. Furthermore, Messier, Martinov-Bennie, and Eilifsen (2005, p. 184) specifically recommended research that examines materiality decision-making in a non-financial context.

[2] The concept of independence is central to accounting professional ethics and the quality of financial audit. A more independent professional judgment is reached by parties that are external to a company.