**Subject: Open letter about financial materiality assessment process**

KnowShape was founded in 2014 as a research spin-off from Ca’ Foscari University of Venice, integrating the results of two research projects on risk measurement and forward looking information started in 2002.

Mission: to develop solutions for constantly improving the capability of companies (banks, insurance companies, corporates, SMEs) to assess and manage uncertainty about the achievement of their economic-financial and ESG sustainability targets.

Distinctive features: KnowShape solutions allow the production of forward looking risk indicators (for every variable of interest for banks, insurance companies, corporates and SMEs) through a proprietary methodology for collecting and processing the knowledge of experts of the company and/or independent advisors.

The materiality assessment process of the ISSB Sustainable Disclosure Standards envisages:

- Three scopes of analysis: impacts, risk, opportunities.
- The adoption of the single materiality criterion regarding the financial performance, related to the financial consequences of the sustainability matters.

Our opinion is that the materiality assessment of ISSB has some limitations, as it does not explicitly consider some contents and some distinctions that are relevant for the information provision process that must be applied by firms.

In particular, its main limit is the indeterminacy of the materiality assessment process’s application areas. The materiality assessment process is referred without distinction both to issues aimed at defining the targets of the financial plan, and to issues aimed at analysing the resilience of the financial plan and the subsequent risk management.

The materiality assessment of the financial plans’ resilience is necessarily subsequent (from a logical and temporal point of view) to the materiality assessment required for defining the targets. This because, in order to analyse the resilience of an financial plan, it is necessary that the financial plan has already been defined in detail.

The analysis of the Draft ISSB suggests that the latter require both issues to be considered in order to represent the financial plan in all its aspects. However, this requirement should be made explicit, without leaving any interpretative doubts on the matter. Furthermore, the generic way in which the materiality assessment process is described does not allow to understand how to decline it in terms of target definition and resilience analysis, namely, to understand which assessments described in the Draft ISSB must be performed to define the targets and which to assess the resilience of the financial plan.
Proposal for improving of the current limit of the ISSB materiality assessment

Our proposal is to distinguish the materiality assessment process to define the financial plan’s targets from the one to identify the possible deviations from these targets, for the purposes of conducting the resilience analysis.

In fact, as detailed below, the materiality assessment process for the targets and the one for the possible deviations differs in terms of: purposes, subject of the 3 scopes of analysis (risk, opportunities, impacts) and timing of execution.

Considering them separately allows to increase the structure of the firm’s reports (avoiding overlapping and confusing different contents) and helps both the firm in preparing the reports and the reader in understanding its contents.

Materiality assessment for financial plan’s targets:

- **Purpose:** assessment for the formulation of the financial plan. It requires the definition of the target values of the financial KPIs for the financial coverage of the sustainability plan.

- **Object of analysis for risk and opportunities (two-sided risk):** to formulate the sustainability plan financial coverage, the risk is intended as the identification of possible future scenarios (assumptions) according to which the target values are calibrated. This risk analysis is done on a limited number of scenarios.

- **Object of analysis for impact:** clarification of the impacts on stakeholders generated by the financial plan targets. This impact analysis is done with regard to the point value of each target.

Materiality assessment for the possible deviations from the financial plan targets:

- **Purpose:** assessment of the financial plan’s resilience. It requires the assessment of the risk related to the sustainability plan’s financial coverage. It requires knowledge of the targets and therefore it must be performed after the materiality assessment for the targets.

- **Object of analysis for risk and opportunities (two-sided risk):** to assess the resilience of the sustainability plan financial coverage, the risk is intended as the domain of the possible deviations from the targets. This risk analysis is done on the entire domain of the deviations that affect a firm. The calculation of the deviations requires knowledge of the targets and therefore the risk and opportunities assessment phase must be performed after the materiality assessment for the targets.

- **Object of analysis for impact:** clarification of the various possible impacts on stakeholders generated by the various possible deviations. This impact analysis is carried out on the entire domain of the deviations. It is proposed that the positive and negative impact assessment introduced by the Draft ISSB should be done with respect to the impact generated by the target; therefore, it must be performed after the materiality assessment for the targets.

The proposal discussed above is based on the contents of the following paper, which is uploaded to provide further details:
Giacomelli A. (2022), Mark to Target Information: idiosyncratic forward-looking information and its use to define primary ESG indicators, Working Papers Series, Department of Economics, Ca’ Foscari University of Venice, No. 08/WP/2022, ISSN 1827-3580
The proposal discussed above is summarized in the following graph, which contains a precise mapping between:

- The idiosyncratic forward-looking information contents defined in the paper abovementioned
- The contents of the proposal to distinguish
  - Financial Materiality assessment for financial plan’s targets
  - Financial Materiality assessment for the possible deviations from the financial plan targets

Signatory
Andrea Giacomelli (KnowShape and Ca’ Foscari University of Venice)