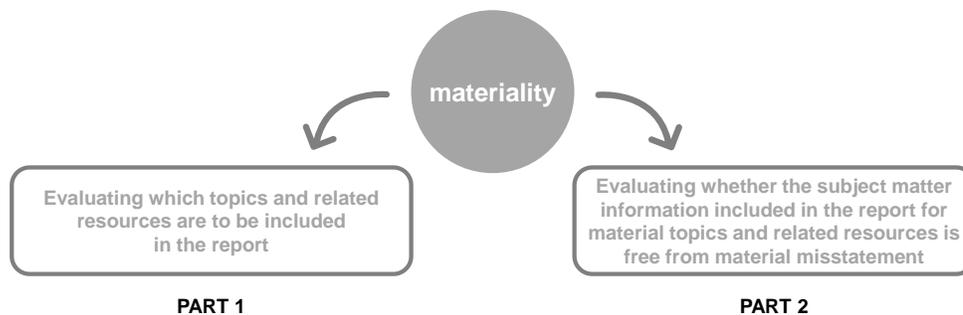


Materiality framework v3.4

Agenda Item 4-A

Introduction

1. ISAE 3000 (Revised)¹ requires the practitioner to “consider materiality when planning and performing the assurance engagement, including when determining the nature, timing and extent of procedures; and evaluating whether the subject matter information is free from material misstatement”².
2. For EER, materiality considerations are required in two key areas³. This guidance is therefore split into two parts:



3. In simple terms, something is material if it could “reasonably be expected to influence relevant decisions of intended users”⁴.
4. The practitioner is required to understand management’s internal control over the preparation of the subject matter information relevant to the engagement. Preparing the subject matter information includes addressing materiality considerations as described above. The following may provide the practitioner a framework for considering the preparer’s ‘materiality process’.

¹ International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

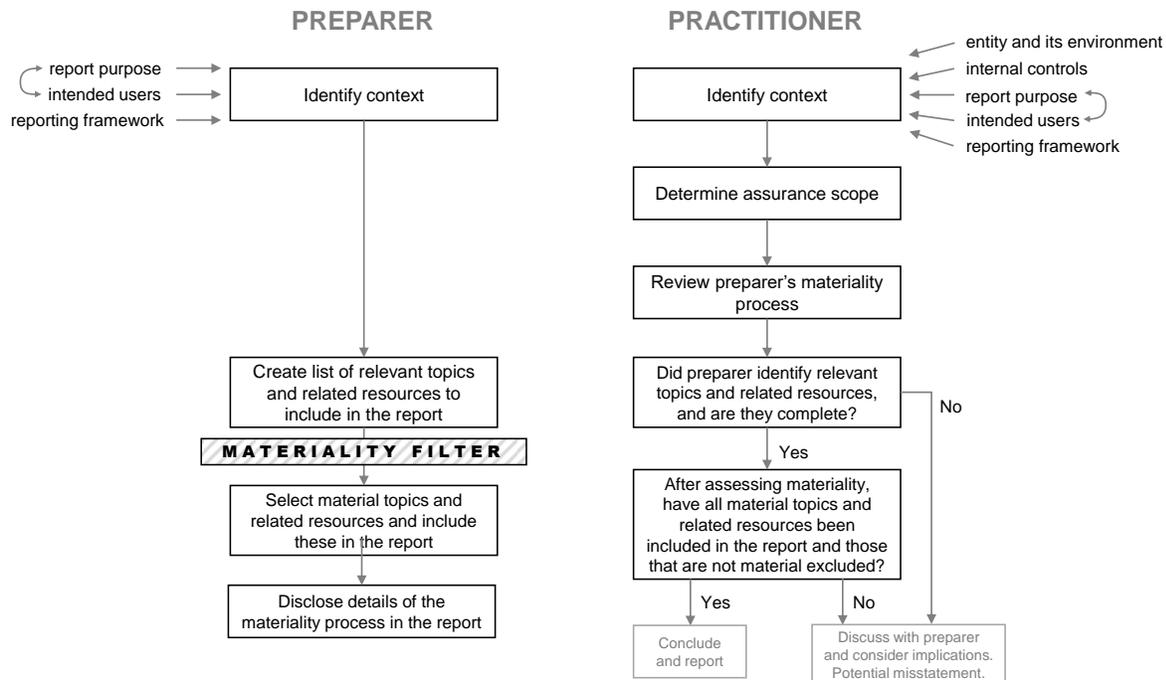
² ISAE 3000 (Revised) paragraph 44

³ Background information about the relative importance of Part 1 materiality considerations in EER engagements will be included in the background information section of the guidance.

⁴ Based on concept in ISAE 3000 (Revised) paragraph A94

Part 1: Evaluating which topics and related resources are to be included in the report

5. The report’s content is primarily the responsibility of the preparer (the ‘responsible party’ in ISAE 3000 (Revised)). The flowchart below shows an example of how the preparer could approach determining what is appropriate to include. Alongside this are steps the practitioner could take to fulfil their responsibilities. These will depend on the scope and nature of the assurance engagement.



6. Ideally a preparer documents their ‘materiality process’ and the decisions they have made so that it can be reviewed by the practitioner. In the absence of written documentation, the practitioner may be able to review the preparer’s process through inquiry of the preparer. If the preparer has not undertaken an appropriate process to determine the content of the report, the practitioner should consider whether the preconditions for accepting the engagement have been met.
7. Use of certain reporting frameworks may establish the report’s purpose and identify who are the intended users. Frameworks may specify the underlying subject matter and the criteria to varying degrees. In some cases this might include specifying the criteria for entities in specific industries to use based on what the framework-setter considers is likely to be material for particular groups of intended users. It is often the case that EER frameworks do not provide a sufficient basis to support the preparer’s materiality decisions.
8. In general, preparers would be expected to begin their process by understanding both the purpose of their report and its intended users. In order to make decisions based on

materiality, it is important for the preparer to understand the general nature of decisions the intended users are likely to take based on, or influenced by, the information in the report.

Purpose

9. The purpose will be to report certain information about an underlying subject matter to a group(s) of intended users. A few examples of the report's purpose might include:
 - To report the entity's impact on the natural environment
 - To describe the entity's activities over a period and how they contribute to the entity's objectives
 - To describe how the entity creates 'value'
 - To inform the intended users of the financial position, financial performance and cashflows of the entity
 - To describe what the entity plans to do in the future, or how it expects to perform

Intended users

10. A single report may have multiple groups of users, with potentially different information needs. Not all these users may be the intended users, but it is only the intended users which preparers and practitioners should focus on.
11. A report cannot focus on the particular needs of an individual user⁵, however a preparer may need to consider where individuals within a group of intended users have common interests.
12. ISAE 3000's application material contains some further guidance, including that in some circumstances where there are a large number of possible users, it may be necessary to limit the intended users to "major stakeholders with significant and common interests"⁶. This might be useful, subject to any particular requirements in the EER framework, where reports are published without specifying the intended users, effectively for the benefit of global society.
13. As an example, a report by a state-run hospital reporting on its clinical performance might have users including:
 - Government – needs to know whether citizens are being provided with adequate healthcare facilities and consequently whether more resources are required.

⁵ ISAE 3000 (Revised) paragraph A94

⁶ ISAE 3000 (Revised) paragraph A16

- General public and wider world – want to know whether the hospital is available to provide care to the community, playing its role in controlling diseases, and if it is clinically safe.
- Cancer patient – self-interest about whether the hospital has the capabilities to treat them successfully.

In this example, the top two user groups might be the intended users, but the individual patient would not be.

14. Different intended user groups may interpret materiality differently; something which is material to one group of intended users may be trivial to another.
15. Intended users may have a relationship and interactions with the entity, or may be directly or indirectly affected by the entity’s actions, or may fall into both of these categories. When considering the intended users, it is also important that preparers and practitioners are aware that there may be intended users who would never read or use the report but may be stakeholders in, or affected by, the entity. The interests of these entities and individuals may however be shared or represented by an other entity(ies) which may be an intended user(s).
16. Some examples of possible user groups are included in the table below – this is not intended to be an exhaustive list, but it could be considered by preparers as a starting point for identifying the intended users of their report by potentially selecting some from the below table and adding entity-specific user groups. It is not necessary for preparers or practitioners to create a detailed list of the intended users – the aim is to have an awareness of the broad groups of intended users as context in materiality judgments.

Example user groups	May influence decision making or be affected by the entity in these areas:
<p>Wider society</p> <ul style="list-style-type: none"> • NGOs / civil society organisations / special interest groups • Members of the public • Researchers, academics • Competitors and other market participants • Vulnerable groups 	<ul style="list-style-type: none"> • Change in the natural environment where they live • Change in lifestyle or quality of life as a result of the entity’s activities • Trading negotiable instruments (in an emissions trading scheme) • Financial decisions (eg. investing) in other entities • Influences the activities of other entities & individuals, including managing natural resources
<p>Governments, regulators and legislators</p> <ul style="list-style-type: none"> • Parliaments and legislators • National, regional and local government • Global organisations • Regulators 	<ul style="list-style-type: none"> • Law and policy making • Monitoring compliance with laws and regulations • Providing national resources (public sector) • Accountability • Decision making on behalf of vulnerable groups
<p>Investors and economic stakeholders</p> <p>Existing and potential:</p> <ul style="list-style-type: none"> • Investors • Suppliers • Customers • Employees • Lenders • Share markets 	<ul style="list-style-type: none"> • Buy or sell equity in the entity • Lend to the entity • Transact business with / use services of the entity • Matters relating to being employed by the entity • Stewardship • Shareholder voting decisions • The entity’s use of their data and personal information

Identifying relevant topics and related resources

17. Taking into account the reporting framework(s) used, the purpose of the report and the intended users, preparers would often create a list of topics and related resources which are relevant to users' decision-making in the context of the underlying subject matter.
18. Topics and related resources are relevant if they contribute to achieving the purpose of the report for the intended users.
19. To identify relevant topics and related resources, preparers could refer to some of the following sources. Practitioners could also refer to some of these sources when testing whether the preparer's list is complete.
 - Discussions with management and those charged with governance
 - Previous reporting by the entity
 - Reporting by peers and competitors
 - Strategy documents prepared by the entity
 - Survey results (of the entity, peers or the industry)
 - Interviews with stakeholders, outreach activities, stakeholder engagement
 - Web and social media searches
 - Global megatrends
 - Sustainable Development Goals
 - Agendas and minutes from board or senior management meetings and committees
 - Risk assessments
20. Stakeholder engagement activities can be an important part of identifying material topics and related resources, and then assessing their materiality. An open dialogue with stakeholders will give better results than passive interaction or asking them to comment on an existing list of topics and related resources, however there is a need to adequately inform stakeholders about the entity and its activities to enable them to engage effectively with the process.

21. Key judgment for the practitioner:

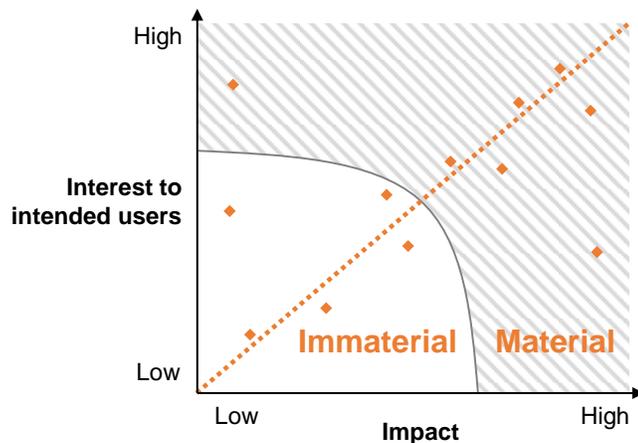
Did the preparer identify relevant topics and related resources as part of their process and are they complete?

Materiality filter

22. Once preparers have a list of relevant topics and related resources, they then select those which are material and should therefore be included in the report.

Practitioners must understand the report's purpose, the intended users, and any reporting framework being used as context for assessing the materiality judgments made by the preparer.

23. One means of assessing how material something is by considering both its 'impact' and the level of interest of intended users. These two variables can be portrayed as axes on a scatterplot.



24. 'Interest to intended users' is the extent to which information could reasonably be expected to influence decision-making by intended users. This could reflect the extent to which the intended users perceive something will impact them. The collective views of intended user groups as a whole should be plotted at one point on the axis rather than making this assessment for individual users.
25. 'Impact' refers to the extent to which the preparer anticipates something will impact on the entity's performance (in achieving its strategic objectives) or will impact on other entities (how the entity's activities is anticipated to affect other entities). This impact could occur either directly due to the actions and decisions of the entity's management, or by the direct or indirect effect of forces external to the entity.
26. The result of the considerations in paragraphs 24 and 25 could be plotted on the scatterplot shown above. The scatterplot may be useful as a tool to compare the relative materiality of topics and related resources. Professional judgment is required to make the decision as to whether something is material or not as the diagram is only an illustration and not a numerical or mathematical model.

27. The table below includes examples of considerations a preparer (and a practitioner, in a reviewing capacity) may have when filtering topics and related resources:

Materiality filter considerations⁷	
Factors to consider for both axes	
<ul style="list-style-type: none"> • The likelihood of an event or circumstance occurring, and the magnitude of its interest to intended users, or of the impact, if it were to occur. 	<div style="text-align: center;"> <p>The scatterplot is a square with a color gradient from light orange at the bottom-left to dark orange at the top-right. The vertical axis is labeled 'Likelihood of occurrence' and ranges from 0% at the bottom to 100% at the top. The horizontal axis is labeled 'Magnitude of effect' and ranges from 'Low' on the left to 'High' on the right. The bottom-left corner is labeled 'Low importance' and the top-right corner is labeled 'High importance'.</p> </div> <ul style="list-style-type: none"> ○ If something is certain or factual, its likelihood of occurrence is at the maximum level and the magnitude is the only variable. ○ The likelihood assessment should take into account whether a matter is inside or outside the control of the entity / management. ○ The position on this scatterplot can be used to assist in determining the appropriate position on either of the axes of the scatterplot shown in paragraph 23.
<ul style="list-style-type: none"> • Careful consideration must be given to information which may be material to intended users in understanding or in making predictions or developing expectations about the future. For example, a small hole in a boat may not be a material piece of information about the condition of the boat at a particular time, but it may be material to understanding the risk of the boat sinking in future. Knowing that the hole exists could change the decisions that a user would make about the risk. 	
<ul style="list-style-type: none"> • The timescale being considered in terms of impact or interest to the intended users. These may not be consistent, for example some users may be more interested in matters manifesting over the short-term (perhaps for an investor with a short-term intended investment period), and less interested in matters which will have a significant impact on the entity in the longer-term. <p>An example to illustrate this might be an entity owning a factory on low-lying coastal land. Rising sea levels are expected to mean the factory site is unusable in five years' time. As there will be no impact for the next five years, this information will not be material to an intended user with a short-term interest in the entity (e.g. an investor expecting to invest for three years). The issue is more material to a bank who has issued a loan secured on the factory site maturing in ten years' time. The preparer must decide</p>	

⁷ Sources include 'The Materiality Report' (AccountAbility, 2006)

<p>over what timescale they are assessing materiality and make sufficient disclosure of this in the report.</p>	
‘Interest to intended users’ axis	‘Impact’ axis
<p>Something is more likely to be material if:</p> <ul style="list-style-type: none"> • It is likely to cause investors to buy or sell equity in the entity • It is likely to change the value of the entity’s share price or enterprise value • There has been media coverage relating to it, or disclosure of it would likely result in media interest (local / national / global?) • There have been a large number of complaints relating to it (e.g. from customers, suppliers or other stakeholders) • It has been mentioned unprompted by several stakeholders • There is a high level of wider societal interest in it, or particularly high levels of public sensitivity <p style="padding-left: 40px;">A few examples in some circumstances might include human rights issues, corruption, amounts of tax paid in jurisdictions of operation, and executive remuneration.</p> <ul style="list-style-type: none"> • It is known to be an area of interest of stakeholders based on the preparer’s prior experience and awareness • It relates to an area of interest in the industry which may be widely reported by peers and competitors in the entity’s sector • It relates to non-compliance with relevant laws, regulations, international agreements, or voluntary agreements with strategic significance to the organization and its stakeholders 	<p>Something is more likely to be material if:</p> <ul style="list-style-type: none"> • It has direct material financial implications (as determined by financial statement materiality thresholds) • It has major risks or opportunities for the entity (including reputational, affecting the entity’s license to operate) • It has, or will potentially have, a major effect on operational performance • It relates to strategic opportunities to boost competitive position • It relates to key organizational values, policies, strategies, operational management systems, goals and targets

28. Topics and related resources or information considered to be relevant and material, which the preparer has not included in the report on the basis that it is confidential, should be treated as a misstatement. The materiality of this misstatement should then be assessed as per Part 2 of this guidance, and the practitioner should then respond accordingly.
29. Topics and related resources should not just be considered individually as there are circumstances where multiple omissions of topics or related resources are in aggregate material. One small hole in a boat may not be material on its own, neither might be another defect on the other side of the boat, or a forecast of bad weather. However, when combined, the circumstances may become more material as the risk of the boat sinking increases.
30. Despite undertaking a process to identify material topics and related resources, preparers may choose to still include some information which is not material. The appropriate response for the practitioner will depend on the engagement scope, however the inclusion of immaterial information is only likely to be problematic if it is misleading or obscures material information. In most cases, intended users may be able to identify and ignore immaterial information easily⁸. If it is misleading, the practitioner should consider this a misstatement due to an invalid assertion (e.g. the assertion of understandability or relevance), assess how material the misstatement is, and respond accordingly.
31. Users are likely to find it helpful in understanding the criteria, to also understand the process the preparer uses in applying the criteria. Accordingly, preparers are often encouraged to disclose details of their materiality process (either in their report, or elsewhere such as their website), giving details of what has been included in the report and what has been left out.

32. Key judgment for the practitioner:

After assessing the materiality of the identified topics and related resources, have all the material topics and related resources been included in the report, and those that are not material excluded?

Other considerations for the practitioner relating to review of management's process

[under development]

⁸ Based on assumptions (a) to (d) regarding intended users in ISAE 3000 (Revised) paragraph A94.

Part 2: Evaluating whether the subject matter information included in the report for material topics and related resources is free from material misstatement

33. If during the assurance engagement the practitioner identifies a misstatement (arising when an identified assertion is not valid), they are required to make a judgment as to whether the misstatement is material.
34. Misstatements in different circumstances will need to be evaluated in different ways given that subject matter information in EER takes such a variety of forms (e.g. quantitative and qualitative, different units of account).
35. For parts of subject matter information which are quantitative (e.g. a KPI expressed in numerical terms), the starting point for materiality decisions is to establish materiality thresholds, often by using a percentage⁹. If the EER framework specifies a percentage threshold for materiality, it may provide a frame of reference to the practitioner in determining materiality for the engagement. For historical financial information which has been subject to an audit, it may be appropriate to use the materiality threshold used for the audit.
36. Below is a series of ‘materiality considerations’ which are examples of things that might be relevant to consider when assessing whether a misstatement is material. The assessment requires consideration of how sensitive the intended users would be to misstatements. This is likely to be different for individual pieces of subject matter information. These considerations are not exhaustive; ultimately, professional judgment will be required to conclude based on the specific circumstances.
 - a) Whether the information is about compliance with a law or regulation & what is consequence for non-compliance
 - b) The number of persons or entities affected by the information
 - c) Whether the information represents a significant change from a position or trend reported previously
 - d) The wording chosen to express the information
 - e) The sensitivity of the information to error
 - f) Whether the information relates to achieving a target or threshold, and the relationship of the actual outcome to the target or threshold
 - g) The importance/significance of the information in the context of the engagement (see Part 1)
 - h) How the information is presented – is it drawn attention to?

⁹ There are instances where this would not be appropriate, perhaps where the number is very small (for example, number of fatalities).

- i) The significance of the information in the industry or sector
- j) The extent of interest shown in the information by, for example, the legislature, funders, the media or the public
- k) The level of uncertainty in the information
- l) Whether a misstatement is the result of an intentional act or is unintentional
- m) Whether the information is about a related party to the entity
- n) Whether the information is volatile – i.e. if it varies considerably from period to period

See Appendix 1 for further guidance and examples.

- 37. The majority of the factors listed as examples in paragraph 36 apply to both quantitative and qualitative information. For information which is quantitative, the factors can be used to set the materiality thresholds, which determines what level of error will be tolerated. For qualitative information, the factors similarly help practitioners decide whether a misstatement is material and how tolerant they can be based on the level of sensitivity of intended user decision-making to such a misstatement.
- 38. The practitioner is unlikely to be able to set an overall materiality (ISAE 3000, paragraph A98) for many EER engagements because the subject matter information very often does not have a common unit of account.
- 39. The practitioner is unlikely to be able to aggregate misstatements and consider them together for a report comprising diverse and varied underlying subject matter. However, the practitioner still needs to consider whether assertions relating to the report as a whole have been met, where such criteria apply in the context of the engagement.
- 40. Knowing the context is important before making materiality judgments – for example understanding the objective/purpose of the disclosure, and how a piece of subject matter information has been measured. The practitioner can then consider whether (i) the disclosure is consistent with the objective, and (ii) whether it is clear and understandable.

In assessing whether something is clearly disclosed, it may be helpful to consider whether the following attributes of the item are included if appropriate:

- a) The risks
- b) Level of uncertainty
- c) Impact (on decision making or on resources)
- d) Comparative information

If these attributes are not clear there is a greater risk of a misstatement.

- 41. It is important to note that higher measurement uncertainty does not necessarily lead to an increased risk of misstatement. When measurement uncertainty is inherent, the

resulting measure may be sufficiently accurate if it is as precise as it reasonably can be and information about the inherent uncertainty is also disclosed. When measurement uncertainty is not inherent, it may give rise to misstatements.

42. If a practitioner identifies a material misstatement, they should follow the requirements of ISAE 3000 (Revised) paragraph 49. If the misstatement remains uncorrected after discussing it with the preparer, the practitioner should follow the requirements in ISAE 3000 (Revised) paragraphs 51, 65, 74, 75 and 77.

Appendix 1 – Materiality Considerations

Materiality consideration	Examples
a) Whether the information is about compliance with a law or regulation & what is consequence for non-compliance	Intended users could be more sensitive about misstatements regarding an instance of non-compliance with an important regulation which attracted a large fine, compared with where an entity has technically breached a law which is frequently ignored by other entities and authorities and where there are no significant penalties.
b) The number of persons or entities affected by the information	
c) Whether the information represents a significant change from a position or trend reported previously	Intended users may have more sensitivity around a significant change rather than a scenario where the outcome is consistent with the past, or is a continuation of a trend. If the trend has been reversed, users may be additionally sensitive to this.
d) The wording chosen to express the information	
e) The sensitivity of the information to error	
f) Whether the information relates to achieving a target or threshold, and the relationship of the actual outcome to the target or threshold	The practitioner must be particularly diligent in circumstances where a target has only just been achieved.
g) The importance of the information in the context of the engagement	The greater the materiality of the subject matter, the lower the tolerance for misstatement. For highly material pieces of information, the practitioner may establish lower materiality thresholds and be less accepting of potentially misleading or inaccurate information.
h) How the information is presented – is it drawn attention to?	Tolerance for misstatement (i.e. the users are more sensitive to misstatements) may be lower for a high-profile disclosure included, say, at the front of the report, or in large or emphasized typeface.
i) The significance of the information in the industry or sector	Something which intended users look for, or use to compare the entity with others in the industry, will be an area of focus for them. Therefore they are likely to be more sensitive to any misstatements.
j) The extent of interest shown in the information by, for example, the legislature, funders, the media or the public	Intended users will be more sensitive to misstatements the wider the extent of the interest in the issue – for example if there has been national-level media coverage there will be greater sensitivity than issues that have not attracted this level of attention.
k) The level of uncertainty in the information	
l) Whether a misstatement is the result of an intentional act or is unintentional	Intentional attempts to mislead users should be taken extremely seriously and will require more detailed work by the practitioner.
m) Whether the information is about a related party to the entity	Users may be more interested in transactions with directors and their tolerance for error may be lower.
n) Whether the information is volatile – i.e. if it varies considerably from period to period	If intended users are expecting volatility, they may be less sensitive to significant changes from previously reported positions.