Statement of Common Principles of Materiality of the Corporate Reporting Dialogue

Background

The Corporate Reporting Dialogue is designed to respond to market calls for greater coherence, consistency and comparability between corporate reporting frameworks, standards and related requirements. The initiative aims to:

- Communicate about the direction, content and ongoing development of reporting frameworks, standards and related requirements
- Identify practical means by which respective frameworks, standards and related requirements can be aligned and rationalized
- Share information, and express a common voice on areas of mutual interest, where possible, to engage key regulators.

The Corporate Reporting Dialogue includes the eight principal organizations chartered with establishing standards and guidance for reporting to investors, creditors and other stakeholders. Regardless of their individual missions, participants share a mutual interest in clarifying reporting concepts based on market demand. *The Statement of Common Principles of Materiality* is one response to this demand.

CDP DRIVING SUSTAINABLE ECONOMIES

CDSB Climate Disclosure Standards Board

GRI Empowering Sustainable Decisions

IFRS

INTEGRATED REPORTING <IR>

ISO

SASB SUSTAINABILITY ACCOUNTING STANDARDS BOARD

Introduction to Materiality

Materiality is a general and pervasive concept and is widely used in financial and non-financial reporting and for many other business purposes. For example, business contracts may include 'material adverse change' clauses, which may or may not be financial in nature. In planning the audit of a corporation, an auditor will establish a materiality threshold for purposes of determining the scope of test procedures, which would be different from the materiality threshold the auditor will use for purposes of rendering the attest report on the fairness of the client's financial statements taken as a whole. Materiality is frequently a legal concept as well because some countries, by either statute, case law or regulation, have established a definition of materiality they require to be applied in their jurisdiction. As an obvious consequence, it is not possible to establish a 'one size fits all' quantified definition of materiality.

The application of materiality is further compounded amongst Corporate Reporting Dialogue participants due to the different context in which their reporting standards are applied. To illustrate, a corporate executive may occasionally falsify his or her expense reports by extremely small amounts. For general purpose external financial reporting, the amount may be clearly inconsequential and therefore immaterial. However if the focus of a different report from the same company was about its business ethics, this same situation may be very material to the primary audience of that particular report. Therefore the Corporate Reporting Dialogue understands each participant organization will need to tailor any definition of materiality to its respective mission; however the Corporate Reporting Dialogue recommends that any modifications adhere to the foundational principle that 'material information is any information which is reasonably capable of making a difference to the conclusions reasonable stakeholders may draw when reviewing the related information'.

Materiality typically needs to be assessed in both historical and prospective contexts. The most common example may be the annual report of a corporation wherein it issues its historical financial statements 'as of X date and for the year then ended.' However, one of the purposes of general purpose financial reporting is to have predictive value so an otherwise immaterial event for the most recent past year may have material implications for the future and thus stakeholders would expect current reporting thereon. More colloquially and visually, someone may own a boat, which springs a small leak. At a point in time (i.e. the reporting date), it may have let in only a few gallons of water but no one would deny, if untreatable or untreated, that this is a material event when considered prospectively.

With the above as background, the Corporate Reporting Dialogue is pleased to present the following common principles of materiality statement, which participants may incorporate into their respective standards setting activities. These principles are not a lowest common denominator of the respective participants' approaches to materiality; to the contrary, they represent common foundational principles that the Corporate Reporting Dialogue believes to be generally applicable to all forms of standards development and business reporting to stakeholders.

Common Principles of Materiality

Introduction

- The concept of materiality is pervasive throughout the business, financial, legal and regulatory communities of the world and accordingly there are many definitions and measures of materiality. While each serves different purposes and operates in different contexts, all are definitionally aligned in that material information is any information which is capable of making a difference to the evaluation and analysis at hand.
- Materiality is both a general and a legal concept. For purposes of this Statement of Common Principles of Materiality, its focus is on the materiality principles underlying the Corporate Reporting Dialogue participants' standards setting activities and on the reporting by business enterprises in compliance with those standards. Legal authorities such as regulators may require or enforce different definitions, which may be more or less restrictive.

Concepts

- The definition of materiality focuses on the material information needs of the primary stakeholders for the report being issued. Further, the focus of reporting should be on primary stakeholders as a group and not on a single or atypical stakeholder or one who is behaving unreasonably or irrationally. Lastly, when preparing reports to and for the benefit of the primary stakeholders of that report, management is entitled to assume that the stakeholder has a reasonable knowledge of business activities and will diligently study the information presented.
- Since the definition of materiality indicates that material information is that which is reasonably capable of making a difference to the proper evaluation of the issue at hand, it follows then that immaterial information cannot and does not make such a difference.
- Business reporting to stakeholders of necessity requires the aggregation of large amounts of detailed transaction and other information into a manageable reporting format. When Corporate Reporting Dialogue participants do not specify required elements or disclosures, judgment is necessary to determine the appropriate level of aggregation or disaggregation of detailed information.
- The Corporate Reporting Dialogue recognizes that a reporting entity may disclose immaterial information in a report, but believes the inclusion of immaterial information in a report must not obscure that information which is material and, consequently, make the report less understandable.
- Materiality must be evaluated and applied in context; what is material information in one context may be immaterial in another.
- When developing new standards of reporting and disclosures, Corporate Reporting Dialogue participants should always note that their detailed promulgated requirements need not be applied if an item is not material to the reporting entity when viewed from the perspective of its primary stakeholders.

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Application

- Assessment of what is or is not material is primarily qualitative and therefore judgement is both critical and necessary. Quantitative materiality thresholds have a role in this process but generally are not dispositive by themselves. If an applicable legal authority has a more restrictive materiality requirement or definition than those included by the Corporate Reporting Dialogue members in their respective standards, the legal definition or requirement supersedes any guidance issued by Corporate Reporting Dialogue member organizations. In fact, deliberate failure to comply with the applicable legal requirements may, by itself, be a material event.
- Business management is ultimately responsible for determining which information is material, i.e. relevant, to the purposes of its primary stakeholders (such as investors), for being reported. This assessment is made from the perspective of stakeholders and not the perspective of management and should reflect management's best interpretation of stakeholder expectations as of the reporting date.
- Business reporting often includes multiple periods of comparable information. Information is typically most material in the year in which the underlying transaction or event occurs and may diminish in relative importance over time. Consequently, it may not always be necessary to repeat the same level of detailed information in subsequent periods.
- It is frequently necessary to make estimates when preparing reportable information. When estimates of, or about, material information are necessary, such estimates should be free from bias, objectively consider all reliable and available inputs and other evidence and consider the material information needs of relevant stakeholders.
- Consequently, when applying the concept of materiality, the Corporate Reporting Dialogue does not expect reporting entities to report or disclose information more precisely than such information is inherently capable of being reasonably measured.

Misstatements and Errors

- Material misstatements of reported information can occur in several ways: Omissions (i.e. excluding relevant information); Errors (e.g. the incorrect use of available information), Irregularities and other causes such as presenting or describing information obscurely or ambiguously. When material misstatements occur, they must be corrected if the report in which they are included is still relevant to its primary stakeholders. Different Corporate Reporting Dialogue participants and related regulators typically have established the required reporting and disclosure standards, which should be referred to for guidance.
- When a misstatement is deliberate and made primarily or solely for achieving a particular reporting result, it should always be considered a material error because it is assumed to have been made with the intention to deceive.

Comparison of materiality definitions and approaches by Corporate Reporting Dialogue participants

	Definitions / Principle	Scope / Boundaries	Comments / Discussion
CDP	See CDSB definition	See CDSB discussion	See CDSB discussion
CDSB	Environmental information is material if: (1) The environmental impacts or results it describes are, due to their size and nature, expected to have a significant positive or negative effect on the organization's current, past or future financial condition and operational results and its ability to execute its strategy; or (2) Omitting, misstating or misinterpreting it could influence decisions that users of mainstream reports make about the organization.'	Audience/scope is the same as those of the IASB. Subject focus narrower as CDSB remit addresses natural capital - i.e. environment, climate change, etc.	Objective of CDSB is to advance the mainstream corporate reporting model to equate natural capital with financial capital. CDSB provides tools to reporting entities to report environmental information with the same rigor as financial information. CDSB's definition of materiality has considerable alignment / similarities to the IASB definitions but goes further by directly including a reference to an entity's ability to execute its strategy.
FASB	Current: 'Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information of a specific reporting entity. ...' Status as of February 2016: There is an active FASB project reconsidering the definition of materiality which has the potential for changes in the scope and general application for entities which report in accordance with US GAAP. No final decisions have been made and overall project direction remains to be determined.	In process of being evaluated with potential for revision.	In process of being evaluated with potential for revision.

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	Definitions / Principle	Scope / Boundaries	Comments / Discussion
GRI	'Material Aspects' are those that reflect the organization's significant economic, environmental and social impacts; or that substantively influence the assessments and decisions of stakeholders.	Stakeholders broadly defined as entities or individuals that can reasonably be expected to be significantly affected by the organization's activities or products and services; and whose actions can reasonably be expected to affect the ability of the organization to successfully implement its strategies and achieve its objectives. '**Aspects**' refers to the list of subjects covered by GRI guidelines and cover a range of a reporting entity's economic, environmental and societal activities and impacts.	Materiality is the threshold at which Aspects become sufficiently important that they should be reported (i.e. they become '**Material Aspects**').
IASB	**Current:** 'Information is material if omitting or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. …' **Proposed:** Information is material if omitting it or misstating it could influence decisions that the primary users of general purpose financial reports make on the basis of financial information about a specific reporting entity.'	Scope is narrowly defined as any assessment of materiality would be limited to the reporting entity and more specifically its financial statements prepared in accordance with IFRS. Intended audience is primary users of financial statements (current/ potential capital providers, lenders) in order to assist in making hold, buy, sell, lend and similar investment and credit decisions. Further, primary users are defined to be those users with a general knowledge of business and economics and the willingness to diligently study the financial information presented.	Scope/boundary discussion is focused on the IASB's proposed definition of primary users, which is somewhat more restrictive than their current definition. The Current definition is in the existing Conceptual Framework and the proposed definition is an Exposure Draft on a revised Conceptual Framework, which should be finalized in 2016. Materiality is assessed/evaluated in the context of how the omission or misstatement could influence primary users especially regarding their assessments of future cash flows and stewardship.

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	Definitions / Principle	Scope / Boundaries	Comments / Discussion
IIRC	A matter is material if it could substantively affect the organization's ability to create value in the short, medium or long term.	Scope of reporting is towards providers of financial capital with focus on what is material to an assessment of how an organization creates value over time.	Frame of reference for assessing materiality is the organization's **value creation process**. This process is influenced by a range of factors, including the organization's use of or effects on 'the capitals'. The International <IR> Framework categorizes these capitals as financial, manufactured, intellectual, human, social and relationship, and natural capital. The materiality determination process applies to both positive and negative matters, including risks and opportunities and favourable and unfavourable performance or prospects. It also applies to both financial and other information.
ISO	An organization should review all the core subjects to identify which issues are relevant. The identification of relevant issues should be followed by an assessment of the organization's impacts. The significance of an impact should be considered with reference both to the stakeholders concerned and to the way in which the impact affects sustainable development.	Broad, inclusive definition of stakeholder as 'an individual or group that has an interest in any decision or activity of an organization. 'Scope' of reporting extends to both those activities an organization has control over but may situationally extend to other organizations and activities that the reporting entity has the ability to influence (its 'sphere of influence')	Uses word 'significance' in lieu of 'materiality' in ISO 26000 (Social Responsibility) guidance. Intention appears to be the same. Therefore, materiality/ significance needs to be very broadly evaluated, as stakeholder group is diverse and the reporting obligation appears to include/ extend to non-controlled organizations or activities the reporting entity can influence.

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	Definitions / Principle	Scope / Boundaries	Comments / Discussion
SASB	SASB standards are developed using the definition of "materiality" applied under the U.S. federal securities laws. That definition, set forth by the U.S. Supreme Court in *TSC Industries v. Northway*, 426 U.S. 438 (1976), is that a fact is material if "there is a substantial likelihood" that a "reasonable investor" would view its omission or misstatement as "having significantly altered the total mix of information." SASB identifies sustainability topics that are reasonably likely to be material for a specific industry and then develops corresponding metrics. A company's management must determine whether the relevant SASB standard should be used to comply with the disclosure requirements of the federal securities laws.	SASB standards are developed for 79 industries in 10 sectors and can be used by all public companies. The standards apply to U.S. and non-U.S. companies that access capital in the U.S. markets and are subject to SEC reporting requirements. The SASB recommends that issuers follow the same boundaries and timing as they use for financial reporting to the S.E.C, thus ensuring that financial fundamentals and material sustainability fundamentals can be analyzed in a similar context and compared year on year.	SASB standards are designed to be integrated into the MD&A and other relevant sections of mandatory SEC filings such as the Form 10-K and 20-F, so that information is reliable and all investors have access to material, comparable information without the need to source it from questionnaires or purchase it from commercial vendors. SASB's standards development process is evidence-based and market-informed in order to ensure the standards are focused on information that is material, are cost-effective for companies and are decision-useful for investors.

This publication was prepared by:

- CDP
- Climate Disclosure Standards Board
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