



Federal Accounting Standards Advisory Board

November 30, 2016

Memorandum

To: Members of the Board

*Ross Simms*

From: Ross Simms, Assistant Director

*Wendy M. Payne*

Through: Wendy M. Payne, Executive Director

Subj: Education Session: Integrated Reporting—Study on Materiality and Conciseness—**Tab A**<sup>1</sup>

MEMBER ACTIONS REQUESTED:

- This is an educational session. If you have questions before the meeting, please contact me.

**MEETING OBJECTIVES**

The objective of the session is to inform the Board of issues that could impact preparer decisions about what information to present and how to achieve a concise presentation when communicating financial and non-financial information about an entity.

**BRIEFING MATERIAL**

The briefing material includes this memorandum and the following attachments:

Attachment I: Curriculum Vitae provides extracts of the curriculum vitae for each of the speakers joining the Board for this discussion.

<sup>1</sup> The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Attachment II: *What affects preparers' and auditors' judgements about materiality and conciseness in Integrated Reporting?* presents the results of research on preparers' experiences in deciding what information to include and how to achieve concise disclosures in reports. To access the full report electronically, visit <http://integratedreporting.org/resource/factors-affecting-preparers-and-auditors-judgements-about-materiality-and-conciseness-in-integrated-reporting/>

## BACKGROUND

The Board has proposed conceptual guidance for federal financial reporting. The guidance includes concepts regarding the presentation of financial and non-financial information in financial statements and required supplementary information (RSI) and summary reporting. With respect to summary reporting, the proposed concepts state "...summary level information may be most useful to citizens and the level where they will likely begin their review."<sup>2</sup> The concepts for summary reporting also discuss providing users with a range of information such as basic performance goals and measures, sources and uses of resources and financial results, challenges facing the entity, and financial condition and electronically linking additional information.<sup>3</sup> Thus, given the different types of information that could be presented, preparers may need to make decisions about which items of information might be material and how to achieve a concise presentation.

Ann Tarca, Professor, Accounting and Finance, University of Western Australia (UWA) and Marvin Wee, Associate Professor, UWA will join the Board to discuss the results of their recent study on factors affecting preparers' and auditors' judgments about materiality and conciseness in Integrated Reporting. Similar to the users of federal financial reporting, corporate financial report users expressed the need for more relevant and concise narrative reporting and greater alignment with strategy, risks, and key performance indicators. Integrated Reporting applies principles and concepts to facilitate the reporting process and improve the quality of information available.<sup>4</sup>

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<sup>2</sup> Exposure Draft Statement of Federal Financial Accounting Concepts, *Federal Financial Reporting*, September 29, 2016.

<sup>3</sup> Ibid.

<sup>4</sup> Association of Chartered Certified Accountants, International Association for Accounting Education and Research, and International Integrated Reporting Council. *Factors Affecting Preparers' and Auditors' Judgments about Materiality and Conciseness in Integrated Reporting*. August 2016.

**CURRICULUM VITAE (EXTRACT): MARVIN WEE**

**Address:** University of Western Australia, Business School M250, 35 Stirling Highway, Crawley WA 6009  
**Phone:** +61 8 6488 5860  
**Mobile:** +61 4 1292 2035  
**Email:** [Marvin.We@uwa.edu.au](mailto:Marvin.We@uwa.edu.au)

**RESEARCH INTERESTS AND EXPERIENCE**

- Experienced in (1) qualitative research involving interviews and surveys, (2) behavioural experiments that involved the construction and dissemination of online experiment instruments, and (3) collection, management and analysis of data for empirical archival projects.
- Published papers in internationally recognized journals.
- Conducted research for industry: International Integrated Reporting Council, Australian Securities Exchange, Supreme Court of Australia (Perth), publicly listed companies.
- Presented research to regulators and standard setters such as IASB and Australian Securities Investment Commission.
- Obtained grants from Australian Research Council, KPMG, ACCA, IAAER, AFAANZ and CAANZ.

**PUBLICATIONS (5 best in last 5 years)**

- Malone, L., A. Tarca and M. Wee, 2016, IFRS non-GAAP Earnings Disclosures and Fair Value Measurement. *Accounting and Finance*, 56(1): 59-98. (Impact factor: 0.927 ABDC Journal Ranking: A)
- Foster F. D., J. Ng and M. Wee, 2015, Presentation Format and Financial Literacy: Accessibility and Assessability of Retirement Savings Statements. *Journal of Consumer Affairs*, 49(3): 519-549. (Impact Factor: 1.053 ABDC Journal Ranking: A)
- Wee M., A. Tarca and M. Chang, 2014, Disclosure Incentives, Mandatory Standards and Firm Communication in the IFRS Adoption Setting. *Australian Journal of Management*, 39(2): 265-291 (Impact factor: 1.4; ABDC: A).
- Chang M., L. Hooi and M. Wee, 2014, How does investor relations disclosure affect analysts' forecasts? *Accounting and Finance*, 54(2): 365-391 (Impact factor: 0.927; ABDC: A).
- Cotter J., A. Tarca and M. Wee, 2012, IFRS adoption and analysts' earnings forecasts: Australian evidence, *Accounting and Finance*, 52(2): 395-419 (impact factor: 0.927; ABDC: A).

**EDUCATION AND PROFESSIONAL AFFILIATIONS**

**Degrees:** PhD (UWA) Awarded 2006; Master of Finance (UWA) Awarded 1999; Bachelor of Commerce Honours First Class (UWA) Graduated 1997; Diploma of Financial Services (Financial Markets) awarded 2008.

**Academic and professional memberships:** Accounting and Finance Academics of Australia and New Zealand (AFAANZ); Financial Management Association (FMA); CPA Australia

**POSITIONS HELD**

**Current position:** Associate Professor, UWA Business School, Accounting and Finance Discipline Group.

**Previous positions:**

- Academic: Assistant Professor, UWA Business School (2009 – 2010); Lecturer, UWA Business School (2001 – 2007)
- Professional: Associate Director, Bank of Scotland Treasury (2007 – 2009). Research Analyst, NWQ Capital Management (2007)

## CURRICULUM VITAE (EXTRACT): ANN TARCA

**Address:** University of Western Australia, Business School M250, 35 Stirling Highway, Crawley WA 6009  
**Phone:** +61 8 6488 3868  
**Mobile:** +61 419 198 200  
**Email:** [Ann.Tarca@uwa.edu.au](mailto:Ann.Tarca@uwa.edu.au)

### RESEARCH INTERESTS AND EXPERIENCE:

- Experienced in qualitative and quantitative research methods.
- Experience in data collection and analysis for empirical archival projects, interviews, surveys and behavioural experiments.
- Over 30 published papers, in internationally recognized journals.
- Team leader for IAAER KPMG grant for research to inform standard setting for performance reporting (2006-2008); Holder of current IAAER KPMG grant (2015-2017).
- Team leader for research projects with relevance to practitioners. Grants have been obtained from the Australian Research Council, ACCA, IAAER, AAA, AFAANZ, CAANZ and CPA AUST.
- Member of Australian Accounting Standards Board (AASB) and Chair of AASB Academic Advisory Panel

### PUBLICATIONS (5 best in last 5 years)

- Hewitt, M., A. Tarca, and T.L. Yohn, 2015, The Effect of Measurement Subjectivity Classifications on Analysts' Use of Persistence Classifications When Forecasting Earnings Items, *Contemporary Accounting Research*, 32(3):1000-1023 (impact factor: 1.43; ABDC: A\*).
- Brown, P., J. Preiato and A. Tarca, 2014, Measuring Country Differences in Enforcement of Accounting Standards: An Audit and Enforcement Proxy, *Journal of Business Finance & Accounting*, 41(1-2): 1-52 (impact factor: 0.914; ABDC: A).
- Wee M., A. Tarca and M. Chang, 2014, Disclosure Incentives, Mandatory Standards and Firm Communication in the IFRS Adoption Setting, *Australian Journal of Management*, 39(2): 265-291 (impact factor: 1; ABDC: A).
- Aerts, W., P. Cheng and A. Tarca, 2013, Management's earnings justification and earnings management under different institutional regimes, *Corporate Governance: An International Review*, 21(1): 93-115 (impact factor: 1.9; ABDC: A).
- Aerts, W. and A. Tarca, 2010, Financial performance explanations and institutional setting, *Accounting and Business Research*, 40(5): 421-450 (impact factor: 0.957; ABDC: A).

### EDUCATION AND PROFESSIONAL AFFILIATIONS

**Degrees:** PhD (UWA) Awarded 2003; Master of Accounting (UWA) Awarded 1998; Bachelor of Commerce (UWA) Graduated 1979.

**Academic and professional memberships:** Fellow of The Institute of Chartered Accountants in Australia and New Zealand (CAANZ); Accounting and Finance Academics of Australia and New Zealand (AFAANZ); European Accounting Association (EAA); American Accounting Association (AAA) and International Accounting Section of AAA; International Association for Accounting Education and Research (IAAER).

### POSITIONS HELD

**Current position:** Professor, UWA Business School, Accounting and Finance Discipline Group. Head of Discipline, 2012 – present. Deputy Head of Discipline 2006-2012.

**Previous positions:** Associate Professor (Level D) (2007 – 2011); Senior Lecturer (2004 – 2007); Lecturer/Tutor, (1996 - 2004); Lecturer and tutor Curtin University (1996); Australia Institute of University Studies (1997); Karratha College (1988, 1991 - 1995); Chartered accountant, Hungerford Hancock and Offner (1982 - 1985) and private contracting (1985 - 1989); Economic researcher, WA Department of Resources Development (1979 - 1981). **Academic Fellow:** IASB Education Initiative, IFRS Foundation, London (July 2011- June 2012)

**Visiting lecturer:** University of Amsterdam September – December 2007.



# What affects preparers' and auditors' judgements about materiality and conciseness in Integrated Reporting?

*Marvin Wee, Ann Tarca and Lee Krug (University of Western Australia)*

*Walter Aerts (University of Antwerp and Tilburg University)*

*Penelope Pink and Matthew Tilling (BDO, Perth Western Australia)*

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Federal Accounting Standards Advisory Board

December 2016

# Overview of the study

- Materiality for financial reporting purposes is well-understood. In contrast, materiality in integrated reporting (<IR>) is not so clearly articulated and understood.



3.24 Not all relevant matters will be considered material. To be included in an integrated report, a matter also needs to be sufficiently important in terms of its known or potential effect on value creation. This involves evaluating the magnitude of the matter's effect and, if it is uncertain whether the matter will occur, its likelihood of occurrence.

- Aim - to gather evidence about how companies determine material matters and achieve conciseness in <IR>.

# Overview of the study

- In the context of the financial statements, range of factors expected to affect the judgements of report preparers and auditors about whether possible items are material for disclosure purposes.
- International <IR> Framework suggests that an organisation's materiality determination process should consider the relevance of internal and external factors, as well as matters identified by stakeholders.

Historical  
focus



Future-  
orientated  
stance

## Interviews

- How do integrated report preparers determine which disclosures are material for report users and therefore should be included in their reports?
- How do integrated report preparers achieve conciseness in their reports?

## Integrated and other Reports

- To what extent do companies' corporate reports disclose their materiality determination process?

## Behavioural Experiment

- How does the magnitude and likelihood of an item of information affect report preparers' and auditors' judgements about the materiality of the item?
- To what extent does the type of item of information (e.g., financial, social or environmental) affect judgements about the materiality of the item?



# Interviews – Views of preparers

- Interviews provide insights into how companies are responding to the call to provide material information in a concise way.
- Interviews with 17 staff of 15 companies who had extracts of their reports included in the IIRC's <IR> Examples Database or were members of the <IR> Business Network.

Departments (#staff)
Corporate finance (5)
Corporate social responsibility (6)
Investor relations (6)

Countries (#companies)	
Australia (3)	Singapore (1)
Canada (1)	Spain (1)
Denmark (1)	Spain (1)
Germany (1)	Sri Lanka (1)
Netherlands (3)	United Kingdom (2)

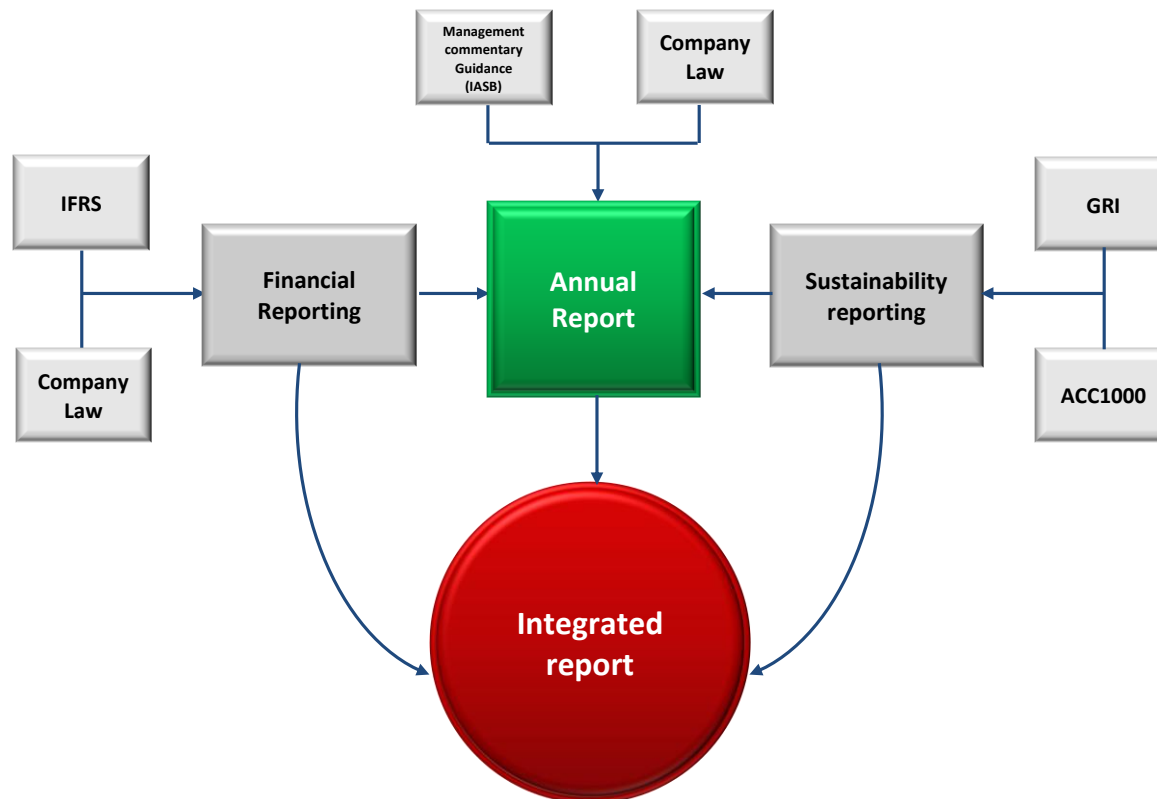
- 6 companies produced report/s called an integrated report and 9 companies in the process of developing an integrated report.

- Interviews were transcribed and checked for accuracy
- Transcripts were analysed by two members of the research team using the following procedure.
  - Each person worked independently to identify themes and subthemes within the interview, by reading and coding three interviews.
  - The two researchers then compared their lists of themes and subthemes and agreed upon a final list for coding, which they then applied to the three interviews.
  - The researchers compared their final coding of the three interviews. Any discrepancies in coding were discussed and reconciled.
  - Following this step, each researcher proceeded to code the remaining interviews.

# Interviews – Findings

## Producing an integrated report

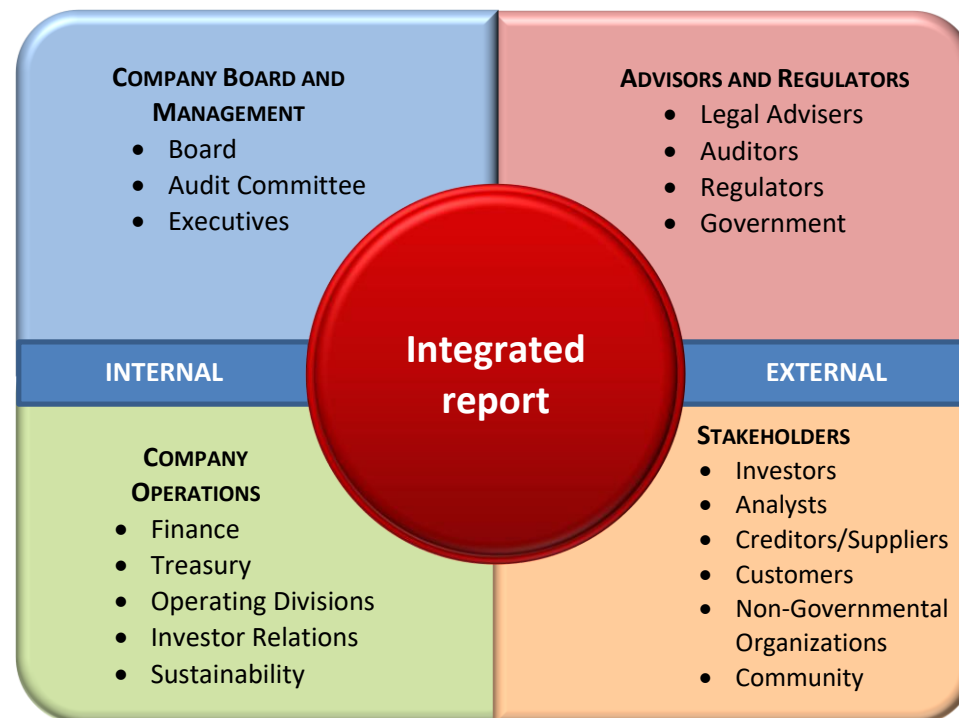
- For many companies, the process of issuing or developing an integrated report has occurred over time, reflecting the influence of a large number of reporting frameworks



# Interviews – Findings

## Producing an integrated report

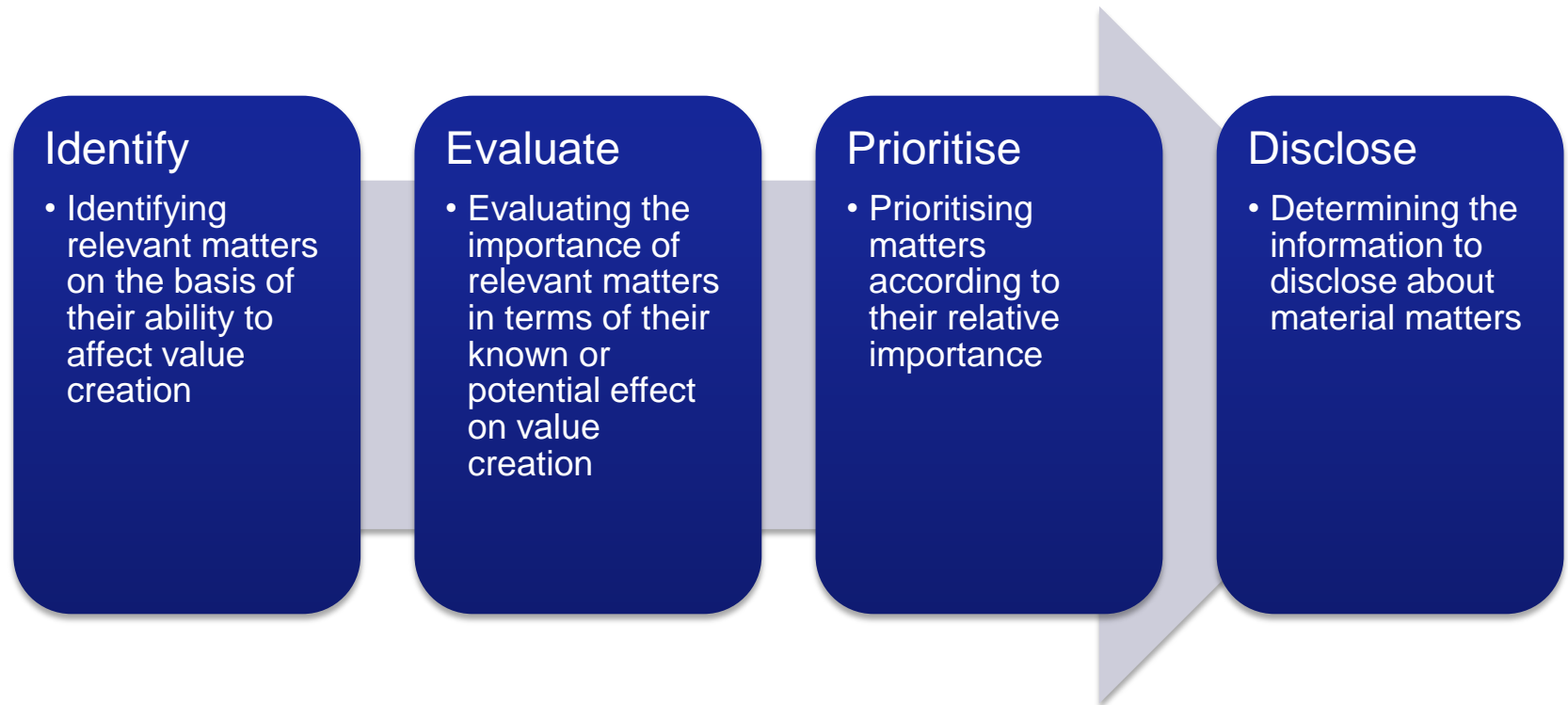
- Within any company, managers and staff from many sections or divisions are likely to be involved in the preparation of corporate reports, including an integrated report.



# Interviews – Findings

## Determining materiality

- Framework provides guidance about how to determine whether an item is material.





# Interviews – Findings

## Determining materiality

- Interview questions 4 and 5 - How do you decide what is included in the report? How do you determine whether an item is material?

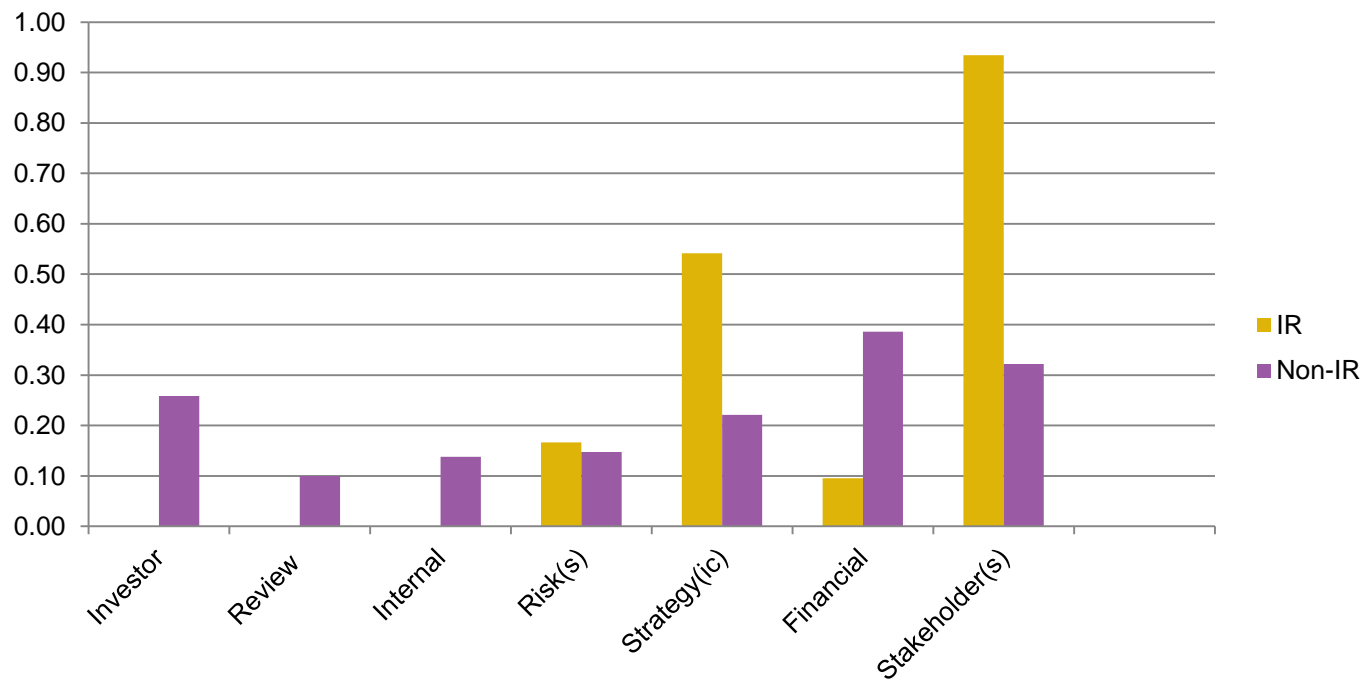


Figure 3.4: Incidence of key words on the 'Content' and 'Materiality' themes weighted by 'Material(ity)' in questions 4 and 5

# Interviews – Findings

## Determining materiality

- Summary of content in transcripts
  - *Identify*
    - Conduct meetings or surveys of stakeholders, many are ‘external audience’.
    - Ask stakeholders to prioritise topics, according to their importance to them.
    - Engage consultants to collect data.
    - Conduct a media review to find material items.
  - *Evaluate*
    - Create a materiality matrix.
    - Weight items.
    - Compare data against targets such as KPIs.
    - Review reporting practices of peer companies and leaders in other sectors.

# Interviews – Findings

## Determining materiality

- Summary of content in transcripts
  - *Prioritise*
    - Carry out internal review of the stakeholder feedback.
    - Use internal and external feedback to determine material items (eg relate to company strategy and value creation).
    - Consider each item's relevance for this period, and whether relevance has changed.
  - *Disclose*
    - Arrive at decisions about what is disclosed, and where, on the basis of the findings of the three previous steps.
    - Take direction from management.
    - Consider strategic risk and operational risk.
    - Seek advice from consultants on disclosure.

# Interviews – Findings

## Achieving conciseness

- Framework states - an integrated report should have ‘sufficient context to understand the organization’s strategy, governance, performance and prospects without being burdened with less relevant information’
- Summary of content in transcripts
  - *Process*
    - Identify areas to be covered and specific targets in each area.
    - Use a specific process for making decisions about content (for example, a process for determining the materiality of items as discussed above).
    - Apply general reporting principles: transparency, consistency, completeness and accuracy
    - Undertake revisions and redrafting.

# Interviews – Findings

## Achieving conciseness

- Summary of content in transcripts
  - *Structure*
    - Use clearly delineated separate sections in the report.
    - Use a content index, to make a clear storyline.
    - Avoid repetition by using links and cross-references.
    - Achieve integration of content in various sections of the report.
    - Create a high-level report, with links to additional information (eg on the website).
  - *Judgement*
    - Focus on the key issues or material matters
    - Capture the essence of the issue, not the full depth and breadth of every aspect of the issue.
    - Link items to the company's strategy and value-creation process.
    - Try to meet user needs, avoiding a 'tick box' approach.



# Interviews – Findings

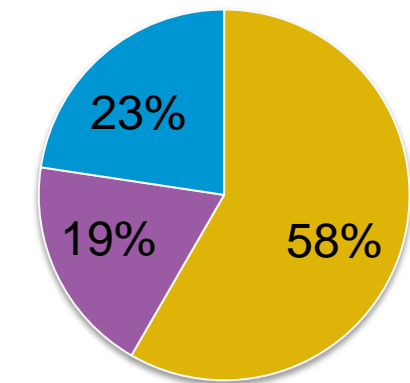
## Challenges in <IR>

- Asked interviewees to comment on regulatory requirements and <IR>, and to describe the challenges experienced in preparing an integrated report or becoming involved in <IR>.
- Summary of content in transcripts
  - *Reporting requirements*
    - The need to meet regulatory requirements dictates certain aspects of corporate reporting.... the usefulness of <IR> will suffer.
    - For some entities, a concise report will not meet regulatory requirements or adequately describe complexity of the business.
    - Multiple reporting requirements mean that several reports must be produced.

- Summary of content in transcripts
  - *Extent of guidance*
    - Framework is very general in relation to materiality.
    - Preparers are drawing on multiple frameworks and using parts they find helpful.
    - The measurement of some items is difficult or subjective thus the items are not reported.
    - Creativity and ‘out of the box’ thinking are required.
  - *Usefulness*
    - Determining and balancing stakeholder expectations is a challenge.
    - Recognising the need to report at the ‘right level’. There is a risk that by trying to satisfy everyone, the report will satisfy no one.
    - Learning how to use the new language such as business models and capitals.

# Integrated Reports - Disclosure in reports

- The publicly available corporate reports of 252 companies were reviewed to discover the extent to which those companies explained the materiality determination process in their reports and disclosed material items.

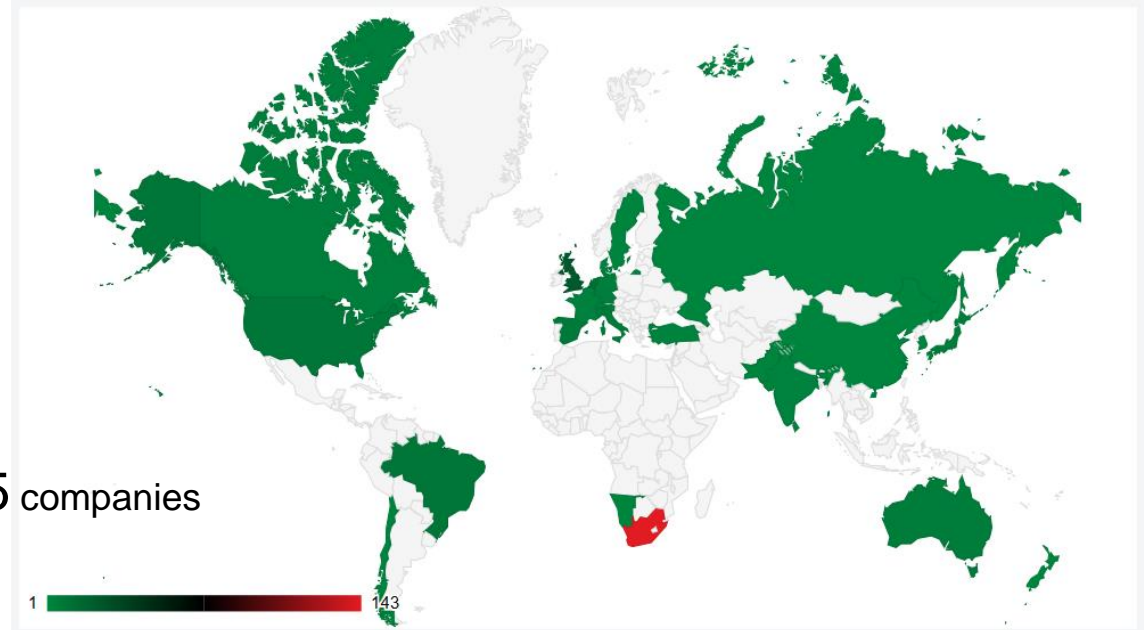


■ <IR>

■ Follow principles of <IR>

■ No reference to <IR>

195 companies



**123** companies included in their integrated report a description of the steps they took to determine materiality of items.

**13** companies stated in another report that this process was undertaken.

**59** companies did not provide a discussion.

- Four steps identified in the framework as the process of determining materiality: (1) identifying; (2) evaluate; (3) prioritise; and (4) determining information to disclose.
- We examine the extent to which the descriptions in the reports covered the four steps.

# Integrated Reports – Findings

- Information about the disclosure of the four steps.

Companies with disclosure of a materiality-determination process		(1) Identify	(2) Evaluate	(3) Prioritise	(4) Disclose
<b>Panel A: All companies with disclosure of a materiality determination process</b>					
<b>Overall</b>	136	121	31	26	102
<b>%</b>	100	89	23	19	75
<b>Panel B: All non-African companies</b>					
<b>Overall</b>	50	44	17	18	35
<b>%</b>	100	88	34	36	70
<b>Panel C: African companies</b>					
<b>Overall</b>	86	77	14	8	67
<b>%</b>	100	90	16	9	78



# Integrated Reports – Findings

- Information about the presentation style.

	Companies with disclosure	Lists	Figures	Tables	Text
<b>Panel A: All companies with disclosure of a materiality-determination process</b>					
<b>Overall</b>	136	24	39	63	117
<b>%</b>	100	18	29	46	86
<b>Panel B: All non-African companies</b>					
<b>Overall</b>	50	10	22	17	44
<b>%</b>	100	20	44	34	88
<b>Panel C: African companies</b>					
<b>Overall</b>	86	14	17	46	73
<b>%</b>	100	16	20	53	85

# Integrated Reports – Findings

- Materiality explanations are often based on lists, figures and tables.

Method	N	Method	N
Text only	38	Text and Tables	32
Tables only	9	Figures and Text	17
Figures only	3	Lists and Text	8
Lists only	1	Figures and Tables	2
		Lists and Tables	1
		Lists and Figures	1
Figures, Tables and Text	10	List, Figures, Tables and Text	2
Lists, Tables and Text	6		
Lists, Figures and Text	2		

- Materiality in relation to non-financial information not well understood.
  - In contrast, concept for financial information guided by accounting and auditing standards.
  - Cheng and Green (2015) – practitioners have less experience in determining materiality of non-financial items. More difficult because of range of measurement scales.
- Experiment investigated whether materiality judgements were affected by the magnitude and likelihood of occurrence of the items and the type of item (eg relating to financial, environmental and social matters)

# Behavioural experiment - Hypotheses

- **H1:** Items with higher magnitude and higher likelihood are viewed as more material compared to items with lower magnitude and lower likelihood.

	Magnitude – high (HM)	Magnitude – low (LM)
Likelihood – high (HL)	Material	Not material
Likelihood – low (LL)	Not material	Not material

# Behavioural experiment - Hypotheses

- **H2:** Items with higher magnitude (of both high and low likelihood) are viewed as more likely compared to items with lower magnitude (of both highs and low likelihood).

	Magnitude – high (HM)	Magnitude – low (LM)
Likelihood – high (HL)		
Likelihood – low (LL)	Perceived more likely	Perceived less likely



# Behavioural experiment - Hypotheses

- **H3:** Financial items are viewed as more material and linked to value creation than environmental and social items.

$$\text{Material}_{\text{Fin}} > \text{Material}_{\text{Others}}$$

	Magnitude – high (HM)	Magnitude – low (LM)
Likelihood – high (HL)	Material	Not material
Likelihood – low (LL)	Not material	Not material

# Behavioural experiment – Method/Instrument

- 2 (*magnitude*) × 2 (*likelihood*) mixed factorial experimental design – ‘within subjects’ manipulation.
  - *Magnitude (Manipulated and Perceived)*:
    - (a) the mine contributed to 20% of company EBIT
    - (b) the mine contributed to 80% of company EBIT.
  - *Likelihood (Manipulated and Perceived)*:
    - Varied through the description of the item
    - For six items (two each of financial, environment and social)

Financial-High	The government of Country A is considering introducing a resource revenue tax to increase its revenue. The new tax has the support of the mining industry and all political parties.
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Financial-Low	The government of Country A is considering introducing a resource revenue tax to increase its revenue. The new tax lacks the support of the mining industry and some political parties.
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# Behavioural experiment - Method/Instrument

- Presents a case scenario based on a draft of the Chairperson's letter to shareholders for a fictitious mining company listed on the LSE and operating in two countries.
  - Referred to events in 2013
  - Items relating to financial, social and environmental matters
- Participants' task to review additional information and indicate whether the items should be included in the letter:
  - Indicate level of materiality
  - Confidence in their assessment
  - Assessment of likelihood of event (perceived)
  - Assessment of magnitude of effect (perceived)
  - Strength of link to value creation for the company

# Behavioural experiment - Data

- Conducted in October 2014 (Perth) and November 2014 (UK)
- Manipulation checks removed 27.
- Table 5.2 shows demographics of participants

Work experience	<i>n</i>
Auditor	31
Accountant/CFO/Financial Controller	47
Other	18
	96
Industry	<i>n</i>
Accounting Profession	39
Mining	30
Other	26
Not stated	1
	96

Education and training	<i>n</i>
Professional	34
Bachelor	35
Masters	11
Postgraduate	12
Not stated	4
	96

Years of experience	Professional work	Preparer	Auditor	User
<i>N</i>	94	61	65	39
Mean	7.0	4.2	4.3	6.8
Min	0.5	0.5	0.3	1.0
Max	28.0	28.0	25.0	35.0
Stdev	6.7	4.4	4.0	7.6

# Behavioural experiment - Results (Table 5.4)

- H1 - participants' scores for **materiality** are higher when both the magnitude and likelihood of the experimental items were greater.

	Magnitude – high (HM)	Magnitude – low (LM)
Likelihood – high (HL)	67.28	55.22
Likelihood – low (LL)	54.55	43.54

# Behavioural experiment - Results (Table 5.4)

- H2 - magnitude affects the assessment of likelihood (perceived) in materiality judgements

	Magnitude – high (HM)	Magnitude – low (LM)
Likelihood – high (HL)	68.25	59.41
Likelihood – low (LL)	66.19	53.81

# Behavioural experiment - Results (Table 5.6)

- Table extract for High Magnitude/High Likelihood items

	n	(1) Materiality	(2) Confidence	(3) Likelihood	(4) Value Creation
Environment	101	63.47	76.53	68.69	60.50
Financial	96	78.44	77.71	69.84	79.79
Social	90	59.67	74.11	66.06	62.06

- H3 - participants' perceptions about the value creation and materiality of items were more strongly linked to the financial items
  - Regression models provide support when using perceived likelihood
  - Effect was stronger for the accounting professionals (not auditors)

- The phenomenon of <IR> is in its infancy.
  - We find some have issued reports entitled ‘integrated report’ and others follow some of the principles of <IR>.
  - Most also producing other reports to meet their various statutory requirements.
- Some companies are providing integrated reports because they see a demand.
  - However, there are concerns about the potential legal liability arising from disclosure of new types of information in accordance with the International <IR> Framework, particularly forward-looking information.
  - Some commented that it was difficult to meet the needs of a range of diverse users with one report.



- Another challenge for the future is that some <IR> information may present auditing challenges.
  - Although previous experience of providing assurance on CSR and sustainability reports or reviewing management commentary reports for material inconsistencies with audited financial statements should prove relevant.