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Dear Paul,

Re: The IIRC's Discussion Paper, *Towards Integrated Reporting*

The Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) values the opportunity to comment on the International Integrated Reporting Council (IIRC's) Discussion Paper proposing the development of an integrated reporting framework. In responding, the PAIB Committee seeks to primarily provide the perspective of a preparer of internal and external business reporting. The membership of the Committee is available at www.ifac.org/paib.

General Comments on Integrated Reporting

The momentum and support for integrated reporting should increase rapidly when organizations and report preparers view it as an effort to consolidate various disjointed reports rather than as an additional report in the form of an "integrated report." The primary beneficiaries of the proposal, investors, are also likely to want to read less and receive concise, relevant, and useful disclosures. To achieve conciseness, relevance and usefulness, the integrated reporting framework will need to explicitly address the determination of materiality, particularly in relation to investors and wider stakeholders. Otherwise, the good intention of integrated reporting could be overcome by organizations disclosing too much and, therefore, creating clutter.

The usefulness of integrated reporting ultimately rests on how well environmental, social, and governance (or sustainability) factors have been embedded into organizations so that organizations take a longer-term sustainable perspective. The PAIB Committee believes that an integrated reporting framework should include the various necessary internal steps that organizations need to pursue to achieve high quality integrated reporting. The PAIB Committee's Sustainability Framework encourages integrated thinking at various levels, and that needs to occur so that integrated governance, strategy, management, processes, and systems can support effective integrated reporting.

The PAIB Committee also suggests that how-to guidance for preparers will be important to help them to develop or redesign their internal processes to ensure readiness. This needs to be done before integrated reporting becomes mandatory.

To provide clarity, the final framework and any supplementary guidance should distinguish between the integrated reporting process and an integrated report.

Comments on the specific questions outlined in the Discussion Paper follow.

The World has Changed—Reporting Must Too

Question 1 (a) Do you believe that action is needed to help improve how organizations represent their value-creation process? Why/why not?

Yes, primarily because there is widespread criticism that business reports have become less useful to users, due to their complexity, length, and focus on compliance rather than on effective stakeholder communication.[1] Current external business reporting is typically focused on financial performance, and where organizations disclose sustainability or environmental, social, and governance (ESG)-related information, it is often presented in a disconnected way, so that its relationship to strategy, operations, and financial performance is unclear. Therefore, there should be an emphasis on integrated reporting as a means for organizations to bring various aspects of organizational performance together to provide a coherent and transparent story of how the organization is creating sustainable value for all stakeholders. However, integrated reporting should not strive necessarily to solve complexity in financial reporting in relation to the application of financial reporting standards.

(b) Do you agree that this action should be international in scope? Why/why not?

Yes, an international framework will help foster a common approach across jurisdictions, particularly in terms of concepts, principles, and terminology. In addition, and due to globalization, stakeholders are often based in various jurisdictions.

Towards Integrated Reporting

Question 2 Do you agree with the definition of Integrated Reporting? Why/why not?

There are two parts to the definition: integrated reporting and the main output of integrated reporting being the *integrated report*. The PAIB Committee suggests that an international integrated reporting framework needs to facilitate the process of integrated reporting rather than necessarily focusing on a stand-alone integrated report as the organization's primary report.

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[1] Supported by the findings of IFAC's Business Reporting Supply Chain Project

An integrated reporting framework should recognize that integration within the organization is a prerequisite to effective integration at the reporting level. The nature of this integration needs to be clearly articulated so that organizations recognize and appreciate the steps that need to take place at a strategic, management, and operational level.

As part of integrated thinking, organizations will also need to consider the values, governance, and oversight that are assigned to various types of information. In many organizations, different committees, groups, and employees typically oversee data collection and analysis to support management and disclosure. Typically, different processes and systems support information disclosure in sustainability/corporate social responsibility report from what is included in an annual report and management discussion and analysis. Therefore, different functions or groups might have different data standards and data quality practices that may need to be reconciled within an integrated approach.

The IIRC's Pilot Programme should be used as a basis to develop guidelines for internal integrated thinking, management, and reporting. Such guidelines should also recommend that sustainability/ESG issues, like financial issues, are overseen at a governing body/board level, and that, in some contexts, this might involve establishing a separate sub-committee of the board or ensuring that an existing committee(s) includes sustainability and ESG factors within its remit.

An International Integrated Reporting Framework

Question 3 Do you support the development of an International Integrated Reporting Framework?

In principle yes, but the decision to develop an integrated reporting framework, and the approach decided upon, should take into account the learning arising from the Pilot Programme.

The IIRC's Pilot Programme can be used to explicitly conduct a cost/benefit analysis of preparing an integrated report as described in the Discussion Paper, particularly comparing the cost/benefit in various reporting scenarios, such as including where the integrated reporting principles have been applied in the preparation of the annual report and accounts that include a management commentary prepared in accordance with the International Accounting Standards Board's practice statement on Management Commentary.

Some preparers view the preparation of a separate integrated report as generating additional compliance and cost. They might be more willing to embrace integrated reporting if it is seen as improving something already existing rather than creating an additional burden. In this light, the "2020" graphic on page seven of the Discussion Paper may need modification to better emphasize the pervasiveness of integrated reporting across the various strands of reporting (rather than presenting an additional circle to represent an additional report). A better depiction might be a large circle to represent integrated reporting with all other forms of reporting shown as internal parts within it, perhaps joined with a dotted line to the outer circle representing integrated reporting.

<u>Question 4</u> (a) Do you agree that the initial focus of Integrated Reporting should be on reporting by larger companies and on the needs of their investors? Why/why not? (b) Do you agree that the concepts underlying Integrated Reporting will be equally applicable to small and medium enterprises, the public sector, and not-for-profit organizations?

It is difficult to establish a clear consensus on whether there should be a focus on investors or wider stakeholders. Again, there is also a question of whether integrated reporting needs to be distinguished from an integrated report. While the IIRC might conceive that an integrated report should be focused on investors, this is not clearly the case for integrated reporting more generally. The differing views presented at the PAIB Committee most probably have also been reflected in the IIRC's own discussions. The key issues include:

Arguments for an investor focus

- Preparing a report based on the decision needs of investors will provide preparers more focus, as it will for the IIRC in its efforts to develop a framework. A wider stakeholder model can also be perceived as adding greater cost, and, therefore, might lead to wider resistance.

- Given that investors have different information needs than other users, preparers will have more focus because they can define materiality specifically in relation to investors. Focusing materiality on the sustainability/ESG issues and risks that will likely affect investment portfolio performance over time will help to ensure that investors receive relevant, timely, and comparable information that they require.

- The disclosure of ESG factors that affect the performance of an organization, particularly in terms of risks and opportunities, key performance indicators (KPIs), liabilities, and costs, indicating performance against goals and targets might in fact be better represented in the annual report and accounts (supported by more detailed web-based information and disclosures), rather than in a separate integrated report, particularly if the primary audience is to be investors.

Arguments for a wider stakeholder focus

- Investors can be seen as a large anonymous group. Within this group, it is typically institutional investors that should have a longer term perspective, and, by way of their investments in pension funds, other stakeholders will have aligned interests (i.e., a vested interest in sustainable value creation).

- A wider stakeholder perspective for the integrated report will allow for a clearer link to sustainable stakeholder value generation in terms of achieving long-term sustainable organizational success as a public interest, or social, outcome for all stakeholders. This approach will also make the framework more relevant for other types of organizations than larger publicly listed companies. In this light, it should be noted that a significant amount of the global value creation, as well as use of resources, takes place in small- and medium-sized enterprises (SMEs), public sector organizations, and not-for-profits. Therefore, arguably a framework should also be scalable and applicable to those organizations, especially since many listed companies are small and do not have large reporting teams or resources to support a reporting process.

- In the interests of international harmonization, the only other jurisdiction currently taking integrated reporting forward (South Africa), is proposing a wider stakeholder model based on the Code of Governance Principles for South Africa, which is a stakeholder inclusive based code (in which "the board of directors should consider the legitimate interests and expectations of stakeholders, on the basis that this is in the best interests of the company"). A deviation in approach at this early stage might cause later convergence challenges.

The current approach in the Discussion Paper might cause confusion because it includes the guiding principle *responsiveness and stakeholder inclusiveness*, which rightly encourages an organization to pursue a structured approach to stakeholder engagement. Stakeholder engagement is an important part of determining materiality of sustainability/ESG issues, including what needs to be communicated and disclosed. However, as the Discussion Paper points to an investor-focused integrated report as being the primary report, to avoid uncertainty over the application of materiality in relation to investors, it might also be necessary to clarify whether an organization needs to distinguish between the information needs of its various investors from that of other stakeholders, and how this is to be achieved.

A potential challenge for organizations is that stakeholder engagement can bring dilemmas and pose challenges on how to manage the trade-off between stakeholder expectations. Organizations require a process and criteria for managing trade-offs, and need to be transparent on how these have been managed. Therefore, it may also be necessary for an integrated reporting framework to specify that an organization should explain how it has dealt with contradictions, for example, where various stakeholders have a different perspective and set of concerns that are not easily reconcilable with each other or with the organization's mission, goals and objectives, and strategy.

Business Model and Value Creation

<u>Question 5</u> Are: (a) the organization's business model, and (b) its ability to create and sustain value in the short, medium and long term, appropriate as central themes for the future direction of reporting? Why/why not?

They could be as long as the concept of a business model can be articulated in a way so that SMEs can also understand and apply the concept. Some preparers feel that large organizations typically have business models that are too complex to describe briefly in a concise report. As mentioned below under question 9, we are concerned that integrated reporting cannot provide a common language across organizations, and reconcile the various ways they define terms like "business model" and "value."

A key challenge is that many sustainable development issues, most notably climate change, have intergenerational consequences. However, few organizations make decisions in the context of the intergenerational impacts of their actions. Reports can tell a nice story but not necessarily deal with substantial issues. Therefore, part of the international response has to be the creation of incentives to ensure market participants are encouraged to take a longer-term perspective. For example, current price mechanisms frequently do not encourage organizations to manage the use of assets in a way that recognizes that current consumption irreversibly affects what is available to future generations.

To help align the perspectives of various stakeholders, it might be useful to clearly define the short, medium and long term, perhaps referencing the fact that various market participants might have differing perspectives on time horizons. Our publication due for release in early 2012 titled, *The Environmental, Social, and Governance (ESG) Disclosures Demanded by Investors and Implications for Professional Accountants in Business*, suggests that the investment horizon for institutional investors might typically be approximately five years. For investment appraisal decisions in the public sector, some governments stipulate the long term as being in excess of 30 years. For many decisions, it is unnecessary to consider costs and benefits beyond a few decades. However, decisions potentially impacting the welfare of future generations might require an assessment of costs and benefits beyond what some companies and investors currently define the long term.

<u>Question 6</u> Do you find the concept of multiple capitals helpful in explaining how an organization creates and sustains value? Why/why not?

The concept of multiple capitals could be helpful in identifying and classifying those intangible, as well as tangible, value drivers of business performance that might exist in an organization and the necessary lagging and leading indicators to better understand future results and potential for sustainable value creation. However, the present construct is abstract and without further specification difficult to implement in practice, particularly in relation to many types of capital where there are no standard measurement methodologies. Widely accepted international standards only exist for financial performance. Without reliable measurement based on widely-accepted standards, it is not possible to monitor whether performance is improving and whether a sustainable path is being achieved.

The capitals approach described in the Discussion Paper also does not necessarily help organizations demonstrate how decisions within the organization are contributing to sustainable development. The PAIB Committee fully supports a goal of fostering sustainable economies and societies, but this is ultimately only achievable if organizations better understand how specific ESG factors relate to them, and how their decisions and resulting performance in these capitals responds to sustainability related opportunities and risks, as well as intergenerational impacts of their actions.

Further support might be needed to help organizations recognize whether their strategies and operations are consistent with sustainable development. This might require providing guidance, perhaps sector specific, or references to approaches and tools, which can help deal with significant challenges in achieving a sustainable business model. For example, providing insights on sustainable value creation might require developing an understanding of how an organization needs to manage its assets or "capitals" to perform sustainably, which in some cases requires recognizing that there exist limits that cannot be breached without jeopardizing future well-being, and how to value certain assets, such as environmental assets and liabilities.

Therefore, if integrated reporting is to help organizations and their investors and other stakeholders understand the sustainable performance of an organization, organizations will need to show how decisions have been made regarding trade-offs involved in sustainable development, and how certain tools have been used to deal with these, for example by incorporating external costs and benefits into their decisions, and using enhanced forms of valuation and measurement. Furthermore, areas such as environmental asset valuation and valuing ecosystem services may need further development for the purposes of reliable and comparable disclosure.

It might also be necessary to reconcile the six capitals approach with the three capitals (or stocks) approach that it is used by economists and acts as the basis for considering future wellbeing, i.e., natural (environmental), man-made (physical) and social (human) capital.

Guiding Principles

Question 7 Do the Guiding Principles identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report—are they collectively appropriate; is each individually appropriate; and are there other Guiding Principles that should be added? Why/why not?

The principles do not include scope and boundary. The IIRC might learn from the Climate Disclosure Standard Board's experience of dealing with organizational boundary issues, which are important to get right to help organizations measure and disclose on a comparable basis. There are also other issues of importance to users of business reports, which are not mentioned in either the guiding principles or proposed content, such as timeliness and verifiability.

Content Elements

Question 8 Do the Content Elements identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report—are they collectively appropriate; is each individually appropriate; and are there other Content Elements that should be added? Why/why not?

As part of describing their organizational overview and/or strategic objectives, risks, and opportunities, an improved understanding of an organization and its stakeholder dialogue might involve organizations concisely articulating the key outcomes of their stakeholder engagement and how this has influenced their strategic and operational decisions. This would also provide a rationale on the information they are disclosing in an integrated report.

What Will Integrated Reporting Mean for Me?

Question 9 From your perspective:
(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

The benefits listed in the paper are difficult to argue with; however, we believe more empirical evidence is needed before these benefits can be considered to be conclusive, particularly with respect to the cost of capital. We are concerned with the assumption that integrated reporting will provide better identification of opportunities and development of a common language across the organization. Opportunities for growth or enhancement of a business typically come from external events or risk mitigation strategies with respect to competition. Large organizations are too diverse in expertise to expect a common language with respect to the environmental and other factors that are proposed to be disclosed in an integrated report.

The initial benefit should be focused on developing disclosures about governance, environmental and social factors that are consistent across corporations and industries. Without comparability between entities, it will be very difficult for investors and others to assess the results of one entity versus another.

The ultimate benefit of integrated reporting is to help ensure long-term sustainable organizational success. Professional accountants in business can help to provide quality in the reporting process. Building quality into financial and non-financial reporting processes and systems is ultimately a better safeguard than the assurance applied in retrospect, and is also less costly for organizations.

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?
(c) Do you agree that Integrated Reporting will drive the disclosure of information that is useful for integrated analysis (from the perspective of investors)? Why/why not?

Yes, but the most important challenge is missing. To be useful, the proposed disclosures need to be measured in a consistent way across organizations and industries. That requires the development of global standards to guide what should be reported and how the reported items should be measured (covering environmental, social, and governance factors). Then processes must be developed in organizations to ensure that the information is verifiable and reliable. Processes to collect and gather this data generally are not in place in most organizations. Therefore, we believe that the initial focus of integrated reporting should be on how to measure environmental, social, and governance factors so organizations then can build the processes to report them. Requiring an integrated report before the groundwork is done will not provide useful information to stakeholders.

Consideration also should be given to the fact that this is an additional layer of work for organizations. As a result, a rigorous cost/benefit analysis should be undertaken to ensure that the benefits outweigh the costs. Promoting another initiative to organizations that already are burdened with compliance costs (e.g., IFRS changeover, internal control certification) will need strong justification.

Directors' and officers' liability, especially in relation to forward looking information (that is beyond IFRSs and management commentary), is a significant impediment to effective reporting that needs to be addressed. Some jurisdictions may have greater concerns than others because of the absence of safe harbor provisions. For example, in Australia company directors are subject to the `business judgment rule', which many believe does not offer protection from potential class actions if they make forward looking statements which fail to materialize.

Regulatory considerations are another significant concern. If regulators do not require an integrated report in their individual jurisdictions, many organizations may not provide one.

All of the above is not to say that integrated reporting cannot be done, but that it needs to be a staged approach. Appropriate disclosures and measurements need to be developed. Boards need to contemplate their future roles and regulators need to participate in the process. In our view, this is a long term endeavor and not one to be rushed. A risk is that a rushed development may result in more misunderstanding than valuable information for stakeholders.

Future Direction

Question 10 (a) Do you agree that the actions listed in the Discussion Paper should be the next steps undertaken by the IIRC? Why/why not? Are there other significant actions that should be added? (b) What priority should be afforded to each action? Why?

A key aim of the IIRC should be to ensure coordination and harmonization of how integrated reporting develops internationally. This might also involve facilitating harmonization in terms of metrics and methodologies used in connection to the measuring and valuing of various capitals and assets. This might involve helping to ensure that those groups undertaking various strands of development in relation to integrated reporting are appropriately governed and working in the wider public interest. The IIRC should also consider how to best incorporate the key elements of other frameworks that have been developed, such as the investor-led EABIS framework for company and investor dialogue (http://investorvalue.org/framework.htm), and the Enhanced Business Reporting Consortium and the World Intellectual Capital Initiative framework and sector KPIs.

Finally, the PAIB Committee suggests that the IIRC's work reinforces the importance of integrated reporting as part of a wider communications strategy. This involves effective stakeholder engagement and communicating directly on the importance of material ESG factors to the organization and how it creates sustainable value. Written reports are only one part of the process of communicating value to investors and stakeholders. One-to-one meetings or forums involving a collection of investors and/or other stakeholders are also important ways to communicate performance and sustainable value creation.

Please do not hesitate to contact me should you wish to discuss any of the matters raised in this submission. We also welcome further discussions on how the PAIB Committee can continue supporting the work of the IIRC.

Kind regards,

Roger Tabor
Chairman, IFAC Professional Accountants in Business Committee