

Organizations and Developments in the Emerging Forms of External Reporting (EER) Context

Relevant to the International Auditing and Assurance Standards Board (IAASB) Discussion Paper (DP) *Supporting Credibility and Trust in Emerging Forms of External Reporting*

Q1. In what jurisdictions and in what industries is a more holistic and cohesive form of EER emerging (See DP paragraph 4-13 and 21)?

A1. A summary of the most prominent EER frameworks and initiatives is provided in

Early efforts to reach international agreements and drive sustainable business practices, from the 1960s onwards, were led by international organizations such as the United Nations, the Organisation for Economic Co-operation and Development, and the World Economic Forum.

Subsequently, a variety of international, regional and national organizations have developed EER frameworks and initiatives that encourage companies to report holistically on the broader impacts of their activities (for example, the International Integrated Reporting Council (IIRC), Global Reporting Initiative (GRI), Global Sustainable Stock Exchange Initiative (SSE), Initiative for Sustainability Ratings (GISR)). In some jurisdictions there are also regulatory reporting requirements (for example, the European Union (EU), the United Kingdom (UK), Germany, France, the Netherlands, South Africa and the United States).

While the majority of EER frameworks and initiatives are not industry-specific, there are some that provide industry-specific standards (for example, certain standards issued by International Organization for Standardization (ISO) and the industry sector standards issued by the Sustainability Accounting Standards Board (SASB)).

Q2. What types of stakeholders are calling for organizations to tell their wider story (not just financial) about the impact they have on society and its resources (See DP paragraphs 5-6)?

A2. There is increasing demand for more cohesive reporting from a wide variety of stakeholders: investors, governments, international organizations, non-governmental organizations and wider society (including employees, unions, suppliers, customers, regulators and surrounding communities). These diverse stakeholders have different information needs. The various EER frameworks and initiatives therefore target different stakeholder groups, depending on their objectives. See column B ('objectives') and column E ('stakeholder focus') in **Agenda Item 11 C.2** for further information.

Q3. What are the relationships between the international organizations involved in promoting EER initiatives and how are they related to each other? Do they address similar issues or fundamentally different ones (See DP paragraph 8)?

A3. Many EER frameworks and initiatives aim to promote a holistic approach to reporting. They capture a broad range of information relating to matters such as corporate governance, employees, the environment, human rights, anti-bribery and corruption measures, society and community; similar subject matter to an integrated report. However, the work of some EER organizations has a narrower focus, often focused solely on environmental matters (for example, the Carbon Disclosure Standards Board (CDSB), CDP, Coalition for Environmentally

Responsible Economies (CERES), Financial Stability Board's Task Force on Climate-related Financial Disclosures and some United Nations bodies).

The 'Corporate Reporting Dialogue' established by the IIRC in 2015 (see row 5 in **Agenda Item 11-C.2**) aims to promote greater consistency between the reporting frameworks of its participating bodies: IIRC, CDP, CDSB, GRI, International Accounting Standards Boards (IASB), Financial Accounting Standards Board (FASB), ISO and SASB.

Q4. Are the findings of the IIRC consultation exploring assurance in the context of integrated reporting (See DP paragraph 20) consistent with consultation by other organizations?

A4. The consultation by other organizations is broadly consistent with the IIRC's findings. The GRI and the World Business Council for Sustainable Development (WBCSD) have held discussions on assurance engagements with preparers, intended users and practitioners. These discussions emphasized the increasing need for enhancing the credibility of information.

Based on the discussions that the GRI held on credibility and trust, the Global Sustainability Standards Board founded by GRI, is reviewing different means by which the credibility and trust of sustainability reporting can be enhanced.¹

The WBCSD notes that there is no global consensus on a set of generally accepted assurance standards for sustainability. It recommends that the IAASB develops a standard for assurance engagements on sustainability information, leveraging International Standard on Assurance Engagements (ISAE) 3000 (Revised)² and ISAE 3410.³ The WBCSD also recommends that the IAASB considers broadening the scope of such a standard to include assurance on integrated reporting as defined by the IIRC. However, the WBCSD recognized that external assurance on EER is in its infancy and is intertwined with the need for companies to evolve more robust EER reporting practices, and standard-setters to develop more 'assurance friendly', consistent and mature EER frameworks.⁴

Q5. In South Africa, what are the criteria for an integrated report that is issued as recommended by the *King Code of Governance Principles (King III Code)*⁵ (See DP paragraph 11)?

A5. The Integrated Reporting Council (IRC)⁶ of South Africa, established in 2010, which is represented on the IIRC, endorsed the IIRC's *International Integrated Reporting Framework*⁷ for integrated reports in South Africa. The IRC develops local guidance on selected topics to enhance the development of integrated reporting in South Africa.

The Johannesburg Stock Exchange Limited (JSE) Listings Requirements require listed entities to apply the principles of the King III Code, or otherwise explain the non-compliance, with the exception of a few principles related to corporate governance. The King III Code recommends

¹ See also the [GRI January 2016 Newsletter](#).

² ISAE 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

³ ISAE 3410, *Assurance Engagements on Greenhouse Gas Statements*

⁴ See [WBCSD Publication Assurance: Generating Value from External Assurance of Sustainability Reporting](#), February 2016.

⁵ The King III Code is available on the [Institute of Directors in Southern Africa's Website](#)

⁶ The [IRC of South Africa](#), established in 2010, is an association whose members are professional and industry bodies.

⁷ The [International Integrated Reporting Framework](#) is available on the IIRC's website.

the preparation of an integrated report every year that conveys adequate information regarding the company's financial and sustainability performance, and focuses on substance over form. It further recommends that the integrated report include commentary on the company's financial results, discloses whether the company is a going concern, describes how the company has made its money, and conveys both the positive and negative impacts of the company's operations and plans for the financial year ahead. The King III Code also recommends that the Board should have controls in place to ensure the integrity of the integrated report and that sustainability reporting and disclosure be independently assured.

The King Committee recently published the *Draft King IV Report on Corporate Governance for South Africa 2016 (King IV Code)*⁸ for public comment, which is likely to be finalized in November 2016. The King III Code's 'apply or explain' approach has been replaced with 'apply and explain' in the King IV Code, i.e. the application of all the principles is assumed and companies must explain the practices that have been implemented to give effect to each principle. The explanation required is a high level disclosure of the implemented practices and the progress made in the journey to achieving good governance. The draft *King IV Code* recommends an integrated annual report be prepared by both private and public sector organizations in response to the IIRC's *International Integrated Reporting Framework*.

Q6. What type of information is required in Europe by the EU Directive 2014/95/EU⁹ on the disclosure of non-financial and diversity information (the NFR directive) (See DP paragraph 11)?

A6. The reporting requirements set out in the NFR Directive aim to capture the wider impacts of a company's activities. Large undertakings which are public interest entities with an average of 500 or more employees during the financial year shall publish a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters. The information must include:

- (a) A brief description of the undertaking's business model;
- (b) A description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;
- (c) The outcome of those policies;
- (d) The principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks
- (e) Non-financial key performance indicators relevant to the particular business.

Where the undertaking does not pursue policies in relation to one or more of those matters set out above, the non-financial statement shall provide a clear and reasoned explanation for not doing so. The non-financial statement shall also, where appropriate, include references to, and additional explanations of, amounts reported in the annual financial statements.

⁸ The King IV Code is available on the [Institute of Directors in Southern Africa's Website](#)

⁹⁹ This [Directive](#) is an Amendment of the Directive 2013/34/EU

See row 24 in **Agenda Item 11-C.2** for further information

Q7. Are there criteria for the ‘fair, balanced and understandable’ statement that is made by the Board in the annual report in terms of the UK Corporate Governance Code¹⁰ (‘the Code’) (See DP paragraph 11)?

- A7. The Code issued by the Financial Reporting Council (FRC) (see row 26 in **Agenda Item 11-C.2**) requires the Board to state in the annual report that it considers the annual report and accounts, taken as a whole, to be “fair, balanced and understandable and provides the information necessary for shareholders to assess the company’s position and performance, business model and strategy.”

The Code uses the words ‘fair’, ‘balanced’ and ‘understandable’ in accordance with their plain English definitions. Therefore, the FRC concluded that it is not necessary for the Code to set criteria to interpret their meaning; the Code is principles-based and the Board will need to apply judgment in making its assessment of whether the annual report meets these criteria.

The requirement for companies to produce a strategic report as part of an annual report was introduced by new regulations in 2013.¹¹ A strategic report must provide a description of the entity’s strategy, objectives and business model, an explanation of the main trends and factors affecting the entity, including its principal risks, analysis using financial and non-financial key performance indicators, and other nonfinancial information relating to the environment, employees, social, community, human rights issues and gender diversity. The FRC published *Guidance on the Strategic Report* to assist companies with meeting these requirements.¹²

Q8. How are risk management and the design and operation of control activities monitored by those charged with governance (TCWG) (See DP paragraph 50)?

- A8. Responsibilities for risk management, the design and operation of control activities, and the monitoring of controls, are allocated by TCWG and management to line functions within the entity. In the Institute of Internal Auditors’ (IIA) (see row 10 in **Agenda Item 11-C.2**) ‘Three Lines of Defense’ model, operational management is the first line and has ownership, responsibility and accountability for the assessment, control and mitigation of risks. The second line includes various control departments (such as compliance, risk, quality and IT functions) that monitor and facilitate effective risk management and internal communication of risk. The third line is responsible for overall monitoring and is typically the internal audit function.

In the IIA’s model, the external auditor and regulators are outside the ‘lines of defense’ which are limited to internal line functions reporting to management (in the case of the first and second lines) and to both management and TCWG (in the case of the third line). Communications from the lines of defense are sources of ‘assurance’ (for management and TCWG) that the entity is meeting its responsibilities for risk management and internal control.

¹⁰ The [UK Corporate Governance Code](#) is available on the FRC’s website.

¹¹ [The Companies Act 2006 \(Strategic Report and Directors’ Report\) Regulations 2013](#).

¹² [Guidance on the Strategic Report](#) is available on the FRC’s website.

The Three Lines of Defense Model



The King IV Code (see row 29 in **Agenda Item 11-C.2**) promotes a 'Combined Assurance Model' that recognizes five lines of assurance (depending on the perceived 'independence' of the source). The five lines include the established three lines of defense (renamed lines of 'assurance' to emphasize the proactive rather than their defensive aspects), external providers of 'assurance' such as the external auditor, and the entity's governance functions (including the audit committee).

This Combined Assurance Model is also referred to in a paper published by the UK Chartered Institute of Internal Auditors in 2013.¹³ The paper recognizes the 'assurance and advisory' role that internal audit may provide to management, which might also be performed in respect of the preparation of integrated reports.

It has also been suggested in a recent academic paper¹⁴ that, for a financial institution, the external auditor and the regulator should be recognized as a 'fourth line of defense' that can provide 'assurance' that the financial institution is meeting its responsibilities for risk management and internal control. The proposal is based on the fact that both parties monitor these matters and communicate about them with each other and with the internal audit function and TCWG through protocols for auditor-supervisor-financial institution dialogue, which have been reinforced since the financial crisis.

¹³ See pages 9 and 10 of [The role of internal audit in non-financial and integrated reporting](#).

¹⁴ See the [Financial Stability Institute's Occasional Paper No. 11](#).