ICGN
International Corporate Governance Network

CONSULTATION DRAFT OF THE INTERNATIONAL <IR> FRAMEWORK

The IIRC welcomes comments on all aspects of the Draft International <IR> Framework (Draft Framework) from all stakeholders, whether to express agreement or to recommend changes.

The following questions are focused on areas where there has been significant discussion during the development process. Comments on any other aspect of the Draft Framework are also encouraged through the questions.

Key Points

If you wish to briefly express any key points, or to emphasize particular aspects of your submission, or add comments in the nature of a cover letter, then the following space can be used for this purpose. Please do not repeat large amounts of material appearing elsewhere in your comments.

This response reflects the view of global institutional investors.

The International Corporate Governance Network (ICGN) is a global membership organisation of over 600 institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of US$18 trillion. Our mission is to raise corporate governance standards worldwide and we do this through three core areas of activity:

- **Influencing policy** by providing a reliable source of practical knowledge and experiences on corporate governance issues, thereby contributing to a sound regulatory framework and a mutual understanding of interests between market participants;
- **Connecting peers** and facilitating cross-border communication among a broad constituency of market participants at international conferences and events, virtual networking and through other media; and
- **Informing dialogue** around sound corporate governance practices and principles through the publication of materials, exchange of knowledge and advancement of education world-wide.

Information about the ICGN, its members, and its activities is available on our website: https://www.icgn.org.

Promoting better corporate reporting has been a long standing activity for ICGN with the establishment of its Non-Financial Business Reporting Committee in 2004 (renamed Integrated Business Reporting Committee in 2010) and the publication of its Statement and Guidance on Non-financial Business Reporting in 2008. We believe that taking into account broader non-financial issues will help investors to appreciate broader risks and to make better investment decisions.

ICGN is a founding participant of IIRC and supports the concept of integrated reporting. We welcome this opportunity to comment on the draft framework from an investor led perspective. We also welcome the recent establishment of an Investor Testing Group to ensure that investor views are taken into account in the development of the Framework and subsequent stages in the evolution of Integrated Reporting. It goes without saying that Integrated Reporting needs the support of investors if it is to succeed, and it follows that investors as the suppliers of financial capital should be the primary audience for integrated reports. We are pleased to see that this is clearly reflected in principle 1.6. In our view much if not most of what will be reported in an Integrated Report would be equally relevant for other stakeholders; but if the focus on writing for one clearly defined audience was diluted the Report would likely be significantly less valuable to all stakeholders. With the providers of financial capital as the primary audience, the Report would be addressed at the knowledgeable reader rather than an uninitiated audience which should serve the goal of producing a concise Report.

While we understand why the IIRC has broadened the definition of providers of financial capital to include both equity and debt, we wish to stress that the materiality test should be from the perspective of providers of equity. Nevertheless the information will be equally relevant for providers of debt.

Investors welcome integrated reporting and the greater insight it provides, than can be obtained from financial accounts, in bringing together different elements to provide a fuller understanding of the business model, the underlying strategy and how value is created. The stock and flow of capitals provide further helpful insight although it needs to be understood that investors will continue to require a satisfactory return on their financial capital. Whilst we wish to see the development of rigorous metrics for the other capitals, it is unrealistic to expect investors to be content to see returns on other capitals as a substitute for unsatisfactory returns on their financial capital.

ICGN also considers that there should be – over time - a greater emphasis on the quantitative aspects of integrated reporting. Qualitative narrative explanation although helpful needs to be reinforced where possible with rigorous metrics. The proposed principles are silent on the need for quantitative information as distinct from qualitative narrative. Although it is not IIRC's role to develop metrics, it should nevertheless encourage others to develop suitable metrics and KPIs. The work of DVFA/ EFFAs, Project Delphi, the GRI and the SASB initiatives spring to mind here. The reference to metrics in paragraph 1.19 is helpful but needs to be elevated to the level of a principle.

We recognize that final frameworks/ standards once published usually bear a very strong resemblance to the exposure draft. Currently the Framework sets out in great detail *what* Integrated Reporting is, and we would strongly encourage the IIRC to ensure that the final document serves as a genuine guidance document for the *how* of integrated reporting.

In our view integrated reporting will be a work in progress for some time to come, and we expect companies to experiment and develop their capacity to report over time.

<u>Chapter 1: Overview</u>

Principles-based requirements

To be in accordance with the Framework, an integrated report should comply with the principles-based requirements identified throughout the Framework in bold italic type (paragraphs 1.11-1.12).

1. Should any additional principles-based requirements be added or should any be eliminated or changed? If so, please explain why.

There are two parts to this answer: presentation and substantive content.

Paragraphs 1.11-1.12 provide a sensible rubric to encourage preparers to follow the framework and will assist users to absorb the information and to make comparisons. In addition to providing them in the context of specific chapters it would be useful to list them in one place for ease of reference so that repetition, as distinct from helpful emphasis, can be more clearly identified.

However, the key question is whether the principles found in bold and italic type throughout the document are themselves sufficient. By and large the answer is in the affirmative, although they can be vague in places, given the heavy emphasis on explanations of business models, risk and value creation over the short, medium and long term with reference to materiality.

Interaction with other reports and communications

The <IR> process is intended to be applied continuously to all relevant reports and communications, in addition to the preparation of an integrated report. The integrated report may include links to other reports and communications, e.g., financial statements and sustainability reports. The IIRC aims to complement material developed by established reporting standard setters and others, and does not intend to develop duplicate content (paragraph 1.18-1.20).

2. Do you agree with how paragraphs 1.18-1.20 characterize the interaction with other reports and communications?

Yes and this takes forward the aspiration to integrate rather than simply combine different types of report. It is also about encouraging behavioural change on the part of preparers (and for that matter users as well) in integrating thinking, reporting and analysis. We also agree that reporting should be seen as a dynamic continuous process rather than just as a retrospective snapshot.

We find it important to emphasize the need for providing updated information more frequently than annual, for example through the corporate governance section of the website.

The Integrated Report should *eventually* become the principal document that companies in any given jurisdiction are required to publish/ file. By this we mean that the Integrated Report should be the statutory Annual Report in those countries where companies are required to file an Annual Report, Annual Accounts and an Auditor Opinion. The latter should cover both the Integrated (annual) Report and the Accounts. In other jurisdictions it would be the equivalent of the financial statements, auditors' report, MD&A and corporate governance filings. The latter filings may need to continue to be available as supplementary detailed information.

We are delighted that IIRC and IASB have signed a MOU. Specifically we note that the IASB's Management Commentary guidance shows significant overlap with what is required under the IR Framework, and in our view it would be worthwhile to explore further to what degree the IR framework and the guidance for the IASB's Management Commentary could be matched.

3. If the IIRC were to create an online database of authoritative sources of indicators or measurement methods developed by established reporting standard setters and others, which references should be included?

This would be extremely helpful although it would need to be kept up to date as this is a fast changing field and there are number of early stage initiatives.

A non-exhaustive list would include the following:

- International Accounting Standards Board IFRS Practice Statement Management Commentary 2010
- DVFA Effas KPIs for ESG (2010)
- G4 GRI (2013)
- CFA Institute, 'Environmental, Social, and Governance factors at Listed Companies: a Manual for Investors' (2008)
- National references
- Accounting Standards Board (UK), 'Operating and Financial Review'
- Australian Institute of Company Directors & PricewaterhouseCoopers, 'Shareholder friendly report'
- Institute of Chartered Accountants in Australia, 'Extended performance reporting: an overview of techniques'
- Australian Securities and Investments Commission, Regulatory Guide 247 on the Operating and Financial Review
- Australian Securities Exchange (ASX), Listing Rule 3.1 and Guidance Note 8 on continuous disclosure
- Canadian Institute of Chartered Accountants, 'MD&A Guidance on Preparation and Disclosure'
- Deloitte, 'Added value, long term: non-financial sustainability key performance indicators on their way into financial reports of German companies' DVFA, Germany
- The Norwegian Society of Financial Analysts, 'Recommended guidelines for the reporting of additional information on value creation'
- King Code of Corporate Governance for South Africa (King III)
- Universities Superannuation Scheme, James O'Loughlin and Raj Thamotheram, 'Enhanced analytics for a new generation of investor'
- US Securities and Exchange Commission, 'Management's Discussion and Analysis of Financial Condition and Results of Operations'
- New Initiatives
- SASB (North America)
- Project Delphi (Europe)

Chapter 2: Fundamental concepts

The capitals (Section 2B)

The Framework describes six categories of capital (paragraph 2.17). An organization is to use these categories as a benchmark when preparing an integrated report (paragraphs 2.19-2.21), and should disclose the reason if it considers any of the capitals as not material(paragraph 4.5).

5. Do you agree with this approach to the capitals? Why/why not?

Yes in principle. This is a helpful model to take forward integration. However metrics are less well developed for some capitals and need to be improved. Subject to this, the stock and flow of capitals provide helpful insight although it needs to be understood that investors will continue to require a satisfactory return on their financial capital.

We wish to point out that the use of the term Capital has triggered substantial discussions. Short of suggesting using different terminology for the Capitals other than Financial Capital, we instead wish to comment more broadly on Value.

Investors would like companies to report on value creation; how this value is created would be part of the Report but it would not be limited to it. From an investor perspective there is value that the company creates for itself and/ or value that it creates for others of which it then captures a part. Investors are eventually focussed on risk-adjusted returns, and wish to understand how the company increases its value (to shareholders) based on all the different capitals mentioned here. The current Framework presents value creation as an aggregate value of all of the Capitals which in our view is unworkable. Value creation should be presented from the perspective of the primary intended report users and one would not expect all ripple effects to be captured.

The current model does not sufficiently address a company's ability to generate profits and how sustainable its resources are. This would require acknowledging the interaction between the company and the individual capitals. Moreover, it would be useful to require that companies specifically address the value proposition for the customer.

To be clear, we consider it of vital importance that a company operates responsibly and takes due care of all the Capitals mentioned here; likewise stakeholders (other than shareholders) influence business drivers and their availability.

Whilst we wish to see the development of rigorous metrics for the other capitals it is unrealistic to expect investors to be content to see returns on other capitals as a substitute for unsatisfactory returns on their financial capital. In general though we caution against artificially monetizing for example, the impact of certain capitals; we consider it in most cases implausible to create a mono-causal link between one factor and profit.

Business model (Section 2C)

A business model is defined as an organization's chosen system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term (paragraph 2.26).

7. Do you agree with this definition? Why/why not?

Yes, although there needs to be some clear overarching purpose of the company that makes it unique. This should not be an overly onerous requirement as all companies should be able to describe their chosen business model. However it can be complex, so this might not be as straightforward as it appears.

Outcomes are defined as the internal and external consequences (positive and negative) for the capitals as a result of an organization's business activities and outputs (paragraphs 2.35-2.36).

8. Do you agree with this definition? Why/why not?

Yes and see also comments above. It is helpful to investors to quantify or monetise outcomes where possible.

9. Please provide any other comments you have about Section 2C or the disclosure requirements and related guidance regarding business models contained in the Content Elements Chapter of the Framework (Section 4E).

We recognize that this will be particularly challenging for conglomerates that have completely different business models operating across the group.

Additionally, we would suggest including within 4.22 the concept of systemic risks created by the actions of the organisation and its industry. This is an important component of the idea of a sustainable and resilient business model.

Chapter 3: Guiding Principles

Materiality and conciseness (Section 3D)

Materiality is determined by reference to assessments made by the primary intended report users (paragraphs 3.23- 3.24). The primary intended report users are providers of financial capital (paragraphs 1.6-1.8).

11. Do you agree with this approach to materiality? If not, how would you change it?

We agree that materiality should be driven by the assessments of investors as the primary intended report users. However, the concept of materiality is complex and goes well beyond the popular but incomplete perception that it must be related to a big number. It will sometimes be a qualitative assessment and about judgement.

Specifically the ICGN's Statement on Non-financial Business Reporting (2008) states that: "Non-financial business reporting is material if it might reasonably be expected to affect investors' decisions about the acquisition and sale of shares or the exercise of ownership rights and obligations."

Issuers cannot be put in conflict with their existing regulatory obligations with regard to materiality. Therefore the IR framework has to be flexible enough to accommodate statutory obligations regarding materiality in different jurisdictions.

12. Please provide any other comments you have about Section 3D or the Materiality determination process (Section 5B).

We strongly agree with the need for conciseness set out in paragraph 3.29 and the reduction of clutter. Integrated reporting should not be about the wild profusion of unmanageable data.

Reliability and completeness (Section 3E)

Reliability is enhanced by mechanisms such as robust internal reporting systems, appropriate stakeholder engagement, and independent, external assurance (paragraph 3.31).

13. How should the reliability of an integrated report be demonstrated?

We agree with paragraph 3.30 that an integrated report should include all material matters, both negative and positive, in a balanced way free from material error. We feel that reports should give a true and fair view. Transparent disclosure will help to demonstrate this whilst boilerplate disclosure will give much less comfort. Robust assurance will help provide credibility in this respect. See also comments below in relation to credibility (section 5E).

Chapter 4: Content Elements

16. Please provide any comments you have about Chapter 4 that are not already addressed by your responses above (please include comments on the Content Element Business Model [Section 4E] in your answer to questions 7-9 above rather than here).

We wish to add 'competence and experience' to diversity and skills of those charged with governance (4.11) because it is about adding value to the Board.

Management remuneration should reflect a holistic view of the company and an approach to managing risk and creating value.

Chapter 5: Preparation and presentation

Involvement of those charged with governance (Section 5D)

Section 5D discusses the involvement of those charged with governance, and paragraph 4.5 requires organizations to disclose the governance body with oversight responsibility for <IR>.

17. Should there be a requirement for those charged with governance to include a statement acknowledging their responsibility for the integrated report? Why/why not?

Yes. Accountability should be at the core of all reporting. As its title suggests, ICGN's core aim is to promote best practice in governance. Management must account for their stewardship and this starts with a fundamental acknowledgement of their responsibility. Para 5.17 sets out the rationale well. It would be helpful to acknowledge the primacy of investors in this reporting relationship.

We would expect those charged with governance to provide a statement of compliance with the IR framework. In our view this should be mandatory. Moreover, we would expect the external auditor to perform a consistency check also for the Integrated Report.

(Non-executive) Directors should state explicitly that they have not only ascertained the reliability and completeness of the financial numbers but also of the content of the Integrated Report. There are examples of such requirements already in some jurisdictions such as Australia (Section 299A of the Corporations Act).

Credibility (Section 5E)

The Framework provides reporting criteria against which organizations and assurance providers assess a report's adherence (paragraph 5.21).

19. If assurance is to be obtained, should it cover the integrated report as a whole, or specific aspects of the report? Why?

Assurance is essential in providing credibility to reporting. In principle, assurance should cover the entire report but this may be unrealistic in the earlier phases. Both assurance and underlying metrics for the different capitals are still evolving and assurance providers will need to invest heavily in building up rigorous testing techniques. We welcome assurance providers' comments on this.

Other forms of assurance can also be valuable, for example the aforementioned statement by Non-executive Directors on the whole Integrated Report or assurance by multi-stakeholder associations.

20. Please provide any other comments you have about Credibility (Section 5E). Assurance providers are particularly asked to comment on whether they consider the Framework provides suitable criteria for an assurance engagement.

We note the distinction between setting the framework for integrated reporting against which assurers need to assess reports on the one hand and the protocol for performing audit engagements. This division of labour between standard setters and auditing standards bodies has been generally helpful in financial accounting. However in order for it to work there needs to be effective dialogue and co-operation between the parties.

The true and fair view used in financial accounting audit may be helpful in integrated reporting as it seeks to test whether the financial statements adhere to the principle as well as the letter.

Clearly the users of integrated reports want to be satisfied that they go beyond bare compliance with the rules.

<u>Overall view</u>

22. Recognizing that <IR> will evolve over time, please explain the extent to which you believe the content of the Framework overall is appropriate for use by organizations in preparing an integrated report and for providing report users with information about an organization's ability to create value in the short, medium and long term?

As companies produce integrated reports the feedback will provide valuable insights into how the framework should evolve. We certainly expect it to be work in progress for some time.

<u>Development of <IR></u>

23. If the IIRC were to develop explanatory material on <IR> in addition to the Framework, which three topics would you recommend be given priority? Why?

- Linkages between the IR Framework and existing disclosure framework
- Database of good practice examples, not necessarily full reports but components/ sections thereof
- Expected involvement of the Board in the process of integrated reporting

<u>Other</u>

24. Please provide any other comments not already addressed by your responses to Questions 1-23.

With regard to paragraph 1.1.2 on page 8 we wish to highlight that the requirement to indicate which information has been omitted and why, can be in breach of regulations. Any explanations should be limited to material information.