BASIS FOR CONCLUSIONS

INTERNATIONAL <IR> FRAMEWORK

INTEGRATED REPORTING <IR>

ABOUT THE IIRC

The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. Together, this coalition shares the view that communication about value creation should be the next step in the evolution of corporate reporting.

The International <IR> Framework has been developed to meet this need and provide a foundation for the future.

Further information about the IIRC can be found on its website www.theiirc.org, including:

- The background to the IIRC's creation
- Its mission, vision and objectives
- Its structure and membership, and the membership of groups who have contributed to the development of the Framework
- Its due process.

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INTRODUCTION

This document provides the IIRC's basis for conclusions on the major technical issues raised by respondents to the *Consultation Draft of the International <IR> Framework* released by the IIRC in April 2013[1] (the Consultation Draft).

It has been prepared by IIRC staff, and relates to but is not part of the *International <IR> Framework* endorsed by the IIRC Council on 5 December 2013 (the Framework).[2]

A further document, *Summary of significant issues,*[3] discusses other issues raised by respondents to the Consultation Draft and includes a summary of the process followed by the IIRC in developing the Framework.

[1] www.theiirc.org/consultationdraft2013/
[2] www.theiirc.org/international-ir-framework/
[3] www.theiirc.org/international-ir-framework/

DISCUSSION OF ISSUES

Issue 1: Fundamental terminology

1.1 Although the terms “Integrated Reporting”, “integrated thinking” and “integrated report” were defined in the Consultation Draft, responses indicated ongoing confusion over this fundamental terminology, for example:

- Some interpreted the term *Integrated Reporting* as the act of preparing an integrated report. Others thought the term represented a much broader process of connecting all internal and external information to clarify how the organization creates value.
- Some viewed the term *integrated thinking* as embodying internal management considerations and organizational philosophy, elements that may already be captured to an extent under the banner of *Integrated Reporting*.
- Some perceived the *integrated report* as a distinct document that may reference information found elsewhere. Within this group, some viewed the integrated report merely as an executive summary of a wider suite of disclosures. Others perceived the integrated report as a more fluid, nebulous concept encompassing a network of communications. (This point is further discussed in Issue 2 *Relationship with other information*.)

1.2 These differing interpretations pointed to a need to:

- Better clarify the meaning of these terms
- Determine the extent to which process, management and philosophy-oriented concepts should be included in the Framework.

1.3 The IIRC concluded that the Framework should separate information about:

- Context/process regarding Integrated Reporting and integrated thinking, which has been placed in the section *About Integrated Reporting* at the front of the Framework
- How to use the Framework and the fundamental concepts underlying it, which has been placed in Part I of the Framework
- The content of an integrated report, which has been placed in Part II of the Framework.

1.4 A clearer definition of Integrated Reporting, which identifies how it relates to both integrated thinking and an integrated report, has also been included in the Glossary in the Framework:

> Integrated Reporting (<IR>): A process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation.

Issue 2: Relationship with other information

2.1 Although the majority of respondents agreed with how the Consultation Draft described the interaction between <IR> and other reports and communications, there was significant confusion about:

- How an integrated report aligns with, refers to and avoids duplication with other reports and disclosures (e.g., financial and sustainability reports)
- Whether the concepts and principles of <IR> should be applied to existing corporate reports and communications, used to prepare a separate report, or both.

2.2 Paragraphs 1.12-1.16 of the Framework have been changed to deal with the form of an integrated report and its relationship with other information:

> 1.12 ***An integrated report should be a designated, identifiable communication.***
>
> 1.13 An integrated report is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or on a website); rather, it makes explicit the connectivity of information to communicate how value is created over time.
>
> 1.14 An integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework it can be considered an integrated report. If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.
>
> 1.15 An integrated report may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. For example, it may be included at the front of a report that also includes the organization's financial statements.
>
> 1.16 An integrated report can provide an "entry point" to more detailed information outside the designated communication, to which it may be linked. The form of link will depend on the form of the integrated report (e.g., for a paper-based report, links may involve attaching other information as an appendix; for a web-based report, it may involve hyperlinking to that other information).

2.3 Various diagrammatical representations of the relationship between an integrated report and other information were considered while revising the Framework. The IIRC concluded that, because of the variety of reporting practices across jurisdictions, it would not be possible at this stage to include a universally-applicable diagram. Consideration is, however, being given to undertaking a project to describe possible pathways towards Integrated Reporting that can help organizations determine the most suitable pathway based on their context and circumstances.

Issue 3: Audience

3.1 The Consultation Draft was based on the IIRC's view that the primary purpose of an integrated report is to explain to providers of financial capital (particularly those with a long term view of an organization's continuation and performance) how an organization creates value over time.

3.2 There was, however, a desire amongst a number of respondents for an integrated report to meet a much broader set of information needs, with over one-third of respondents expressing concern that the Consultation Draft:

- Placed financial capital ahead of the other five forms of capital
- Ranked investor interests above those of other stakeholders
- Implied that monetization of information is necessary.

3.3 The IIRC did not consider a fundamental change to be justified but, taking comments received into account, revised paragraphs 1.6–1.7 of the Consultation Draft (now paragraphs 1.7–1.8 of the Framework) to effectively:

- Shift the 'primary' qualifier from report *audience* to report *purpose*
- Draw an explicit tie to value creation, a connection that many respondents felt was lacking and that the IIRC agreed could be emphasized more

- Elevate the understanding, or expectation, that providers of financial capital consider factors *beyond* financial capital alone.

Consultation Draft	The Framework
1.6 ***An integrated report should be prepared primarily for providers of financial capital in order to support their financial capital allocation assessments.***	1.7 The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. It therefore contains relevant information, both financial and other.
1.7 Although providers of financial capital are the primary intended report users, an integrated report and other communications resulting from <IR> will be of benefit to all stakeholders interested in an organization's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators, and policy-makers.	1.8 An integrated report benefits all stakeholders interested in an organization's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers.

3.4 Underlying this position is the view that:

- Providers of financial capital can have a significant effect on the allocation of all types of capital by determining which organizations to invest in. Even for respondents whose driving interest in <IR> is the contribution it can make to a sustainable planet, how financial capital is directed is one of the keys; it is this key that <IR> is addressing. <IR> helps direct financial capital to sustainable businesses; a sustainable planet and a stable economy require sustainable businesses that support broader societal interests by undertaking long term, as well as short and medium term, value creation within planetary limits and societal expectations.
- Trying to aim at all stakeholders would be a virtually impossible task, particularly in a concise report – to aim at all stakeholders would reduce focus and increase length, which is contrary to the objectives of <IR>.
- Reports aimed at the information needs of a broad range of stakeholders tend to deal with impacts (which is more within the ambit of sustainability reporting), rather than value creation (which is the purpose of <IR>).

3.5 This is not to be misunderstood as saying that integrated reports lack interest for other stakeholders, or that an organization's relationships with other stakeholders are unimportant. On the contrary:

- Many stakeholders are interested in the ability of an organization to create value over time. Integrated reports are of benefit to them, as clearly reflected in paragraph 1.8 of the Framework.
- Stakeholder's legitimate needs and interests are mentioned throughout the Framework, particularly in the Guiding Principle *Stakeholder Relationships,* in recognition of the fact that value is not created by or within an organization alone, but is created through relationships with others, as discussed in the Fundamental Concepts in Chapter 2 of the Framework. <IR> reflects the importance of relationships with key stakeholders and requires that an integrated report provide insight into the nature and quality of the organization's relationships with them, including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.

Issue 4: Materiality – terminology

4.1 Almost 30% of respondents expressed concern over misalignment between the IIRC's use of the term material/materiality and how it is used in other common reporting contexts (e.g., financial reporting and sustainability reporting). Some suggested that the IIRC could provide guidance on determining report content without creating "yet another" definition of materiality. Objections to using the term material/materiality in the Framework were rooted in the following:

- The link between materiality and a *financial threshold* is so well entrenched that it could hamper application of the concept to non-financial information
- Materiality carries with it a certain level of "legal baggage". Some organizations may feel legally compelled to include all information deemed material for regulatory filings in the integrated report.

4.2 To mitigate the above concerns, a number of respondents proposed that the IIRC replace the word "material" with alternatives like significant, relevant important or priority.

4.3 While acknowledging the concerns noted above, the IIRC concluded that, on balance, the term material/materiality should continue to be used as it is well understood in the reporting community and its particular application in the case of an integrated report is adequately explained in the Framework.

4.4 The IIRC intends undertaking a project on materiality, which may include practical examples of how organizations have disclosed their materiality determination process, implementation guidance, and exploration of the relationship between established definitions of materiality and between materiality and the reporting boundary.

Issue 5: Value/value creation and capitals

5.1 There was no specific question in the Consultation Draft about value, but it was clear from responses that there was some confusion around: what is value, what is value creation, value for whom, and does value/value creation need to be quantified?

5.2 Some of the options (which are not mutually exclusive) considered for how to best explain value/value creation included that value is:

- The total of all the capitals
- The benefit "captured" by the organization
- The market value/cash flows of the organization
- The successful achievement of the organization's objectives
- Made up of two interrelated components, being value created for: (a) the organization itself, and (b) others.

5.3 A further option considered was to require the organization to explain what it means by value, or what its stakeholders see as value/valuable.

5.4 The IIRC concluded that the Framework should:

- Not define value from any one particular perspective because what constitutes value depends on an individual's own circumstances and perspective. Rather, paragraphs 2.4–2.9 of the Framework explain that value created by the organization: (a) manifests itself in increases, decreases or transformations of the capitals, and (b) has two interrelated aspects (value created for the organization and for others) that are linked through a wide range of activities, interactions and relationships.
- Reconfirm the position in the Consultation Draft that value/value creation need not be quantified and that an integrated report should not attempt to place a value on an organization – assessments of value are the role of others using information in the report (see paragraph 1.11 of the Framework).

- Include in the Glossary a definition of "value creation" that is based on the explanation in paragraph 2.4 of the Framework
- Give further emphasis to the fact that the term value *creation* as used in the Framework includes instances when value is *preserved* and when it is *diminished* (see paragraph 1.6 of the Framework).

Issue 6: Involvement of those charged with governance

6.1 Just over 50% of respondents to the Consultation Draft agreed (fully or with minor qualification) with adding a requirement to the Framework for a statement from those charged with governance acknowledging their responsibility for the integrated report.

6.2 The main reasons considered for requiring such a statement are that it would:

- Demonstrate that those charged with governance accept their responsibility for the integrated report
- Assist in ensuring the reliability of disclosures and the overall credibility of the integrated report
- Increase accountability for the content of the report.

6.3 The main reasons considered for not requiring such a statement related to:

- No statement being necessary because the Consultation Draft already: (a) stated that those charged with governance "are responsible for ensuring that there is effective leadership and decision-making regarding <IR>, including the identification and oversight of the employees actively involved in the <IR> process" (paragraph 5.17 of the Consultation Draft), and (b) required disclosure of "the governance body with oversight responsibility for <IR>" (paragraph 4.5 of the Consultation Draft)
- The inclusion of a statement may result in additional liability/legal concerns, e.g., imposing a requirement to include a statement could:
  - be inconsistent with legislative or regulatory requirements in jurisdictions where the CEO and/or CFO, rather than those charged with governance, are required to include a similar statement with the statutory annual report
  - lead to a higher level (real or perceived) of legal liability for matters such as future-oriented information, the response to which might be for organizations to adopt a more compliance-oriented approach
- It seems contrary to the market-led, principles-based approach to include a very specific requirement of this nature.

6.4 The IIRC acknowledged that if a requirement for such a statement were included in the Framework, the combination of the above issues might result in a slower take-up of <IR>, particularly in some jurisdictions. Nonetheless, the IIRC considered it more important that integrated reports be, and be seen to be, developed with the involvement of those charged with governance; reports in which they were not involved would not only lack credibility themselves, but the skepticism they induce could also discredit the broader <IR> movement.

6.5 The IIRC decided, therefore, that those charged with governance should, in time, be required to acknowledge their responsibility for the integrated report. This has been included as a requirement in paragraph 1.20 of the Framework.

Issue 7: Suitable criteria for preparation, presentation and assurance

7.1 Various concerns were expressed by a number of respondents about whether the Framework constitutes suitable criteria, both for report preparation and presentation and for assurance. While the term *suitable criteria* is defined in the auditing or assurance literature, and thus is commonly thought of as an assurance term, the Framework needs to constitute suitable criteria for the consistent preparation and presentation of integrated reports, regardless of whether assurance is sought.

7.2 These concerns resonate in the following:

- What measurement standards or criteria are used for the information reported (*further discussed in Issue 8 Measurement and KPIs*)
- Whether the integrated report is complete and how a preparer can ascertain completeness
- Whether the appropriate level of connectivity is reflected in the integrated report.

7.3 Assurance providers were concerned with the above and, in particular, with the ability to assess future outlook disclosures, and recommended that specific criteria used for measurement, range of outcomes and confidence intervals be disclosed.

7.4 The characteristics of suitable criteria (relevance, completeness, reliability, neutrality and understandability[4]) were considered in revising the Framework, recognizing that the preparation and presentation of an integrated report requires the exercise of judgement given the specific circumstances of the organization (paragraph 1.10 of the Framework), and that comparability will likely increase as <IR> evolves and as the IIRC and others develop materials that assists report preparers in exercising their judgement. Further, an additional Content Element, *Basis of Preparation and Presentation,* has been included (Section 4H, paragraphs 4.40–4.48 of the Framework) that requires the integrated report to describe its basis of preparation and presentation, including the significant frameworks and methods used to quantify or evaluate material matters. Also included are two requirements formerly included in paragraph 4.5 of the Consultation Draft, namely:

- A summary of the organization's materiality determination process
- A description of the reporting boundary and how it has been determined.

Issue 8: Measurement and KPIs

8.1 Some respondents were concerned that the Consultation Draft lacked specific rules for measurement or specific KPIs, which could result in a lack of comparability across organizations; they requested: (a) further guidance on measurement rules, and (b) more explicit reference to existing core financial and other KPIs.

8.2 The IIRC reconfirmed the position in the Consultation Draft that the prescription of specific key KPIs and measurement methods is beyond the scope of a principles-based framework. Also:

- The section on "A principle-based approach" (paragraph 1.9–1.10 of the Framework) has been strengthened to emphasize the need to include quantitative indicators in an integrated report whenever it is practicable and relevant to do so, and for consistency of measurement methods across different reports/communications
- Although the Consultation Draft already included brief guidance on the selection of suitable quantitative indicators, that guidance was nested under the Content Element *Performance*. It was agreed that the prominence of this discussion should be elevated and it now appears as a cross-cutting issue in paragraph 4.53 of the Framework
- Consideration is being given to undertaking a project to develop a database of authoritative, external sources of KPIs.

[4] Per the International Auditing and Assurance Standards Board's *International Framework for Assurance Engagement*

Issue 9: Legal liability and competitive harm

9.1 A number of respondents raised concerns about the potential for disclosures (particularly future-oriented ones) to result in legal liability or competitive harm.

9.2 With respect to *legal liability*: The IIRC noted the importance of this issue and the fact that it is being considered from a policy perspective, including the call for "safe harbours" raised by some respondents. The IIRC also retained the exclusion in paragraphs 1.17–1.18 of the Framework allowing an integrated report to not apply the Framework to the extent that specific legal prohibitions result in the inability to disclose material information, and noted the relevance of the:

- Discussion of completeness (paragraphs 3.47–3.53 of the Framework, particularly with respect to future-oriented information at paragraphs 3.52-3.53 of the Framework)
- Reference in paragraph 4.39 of the Framework to legal or regulatory requirements regarding the Content Element *Outlook*.

The IIRC did not, however, think that substantive changes were needed in the Framework (particularly given its principles-based and market-led nature) to respond to the possibility that some information might, in some circumstances in some jurisdictions, result in a potential legal liability to the preparer.

9.3 With respect to *competitive harm*: The wording in paragraphs 1.11–1.12 in the Consultation Draft (now paragraphs 1.18–1.19 of the Framework) has been revised; those paragraphs allow an integrated report to not apply the Framework to the extent that disclosure would cause significant competitive harm. Under the Consultation Draft, an organization taking advantage of this exclusion was required to indicate what information was omitted and explain why. In the Framework, this has been replaced with the following guidance:

> 3.51 In including information about material matters dealing with competitive advantage (e.g., critical strategies), an organization considers how to describe the essence of the matter without identifying specific information that might cause a significant loss of competitive advantage. Accordingly, the organization considers what advantage a competitor could actually gain from information in an integrated report, and balances this against the need for the integrated report to achieve its primary purpose as noted in paragraph 1.7.

DUE PROCESS

A summary of the process followed by the IIRC in developing the Framework is included in the *Summary of significant issues*.[5] In addition to analysis of over 350 submissions received on the Consultation Draft, the vast majority of which were supportive, it included:

- Publication of a Discussion Paper, an Outline and a Prototype Framework, and a series of Background Papers
- Discussions at IIRC Pilot Program conferences, webinars, and regional meetings, involving participants from both its Business Network and Investor Network
- Input from the IIRC Investor Testing Group and IIRC Technical Collaboration Groups
- Extensive outreach activities around the world, including roundtables, seminars, presentations and workshops
- Discussion and feedback on successive iterations throughout the development process at meetings and conference calls of the IIRC Technical Task Force and the IIRC Working Group.

The Framework was endorsed by the IIRC Council at its meeting on 5 December 2013. The IIRC's due process requires that the *Basis for conclusions* include an explanation of the reasons for dissenting votes, if any, of Council members. All Council members in attendance or represented by an alternate or proxy voted in favour of publishing the Framework except the member representing the Australian Institute of Company Directors (AICD) who abstained from the vote. AICD is supportive of many of the goals included in the Framework, especially those related to long term thinking. However, AICD is very concerned that director liability should not be increased by the introduction of the Framework even if the Framework is adopted voluntarily. The lack of a business judgement rule and directors liability provisions in Australia, particularly in relation to forward looking statements are inconsistent with many of the Framework's principles. AICD notes there are encouraging opportunities for flexibility in the Framework and the possibility of reform of the Corporations Act in Australia.

[5] www.theiirc.org/international-ir-framework/

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