



21 December 2011

Our ref: ICAEW Rep 126/11

Your ref:

Professor Mervyn King
Chairman
The International Integrated Reporting Committee

By email: dpresponses@theiirc.org

Dear Professor King

TOWARDS INTEGRATED REPORTING: COMMUNICATING VALUE IN THE 21ST CENTURY

ICAEW is pleased to respond to your request for comments on the discussion paper *Towards Integrated Reporting: Communicating Value in the 21st Century*, and we look forward to contributing to the future work of the International Integrated Reporting Committee.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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TOWARDS INTEGRATED REPORTING: COMMUNICATING VALUE IN THE 21ST CENTURY

Memorandum of comment submitted in December 2011 by ICAEW, in response to the International Integrated Reporting Committee discussion paper *Towards Integrated Reporting: Communicating Value in the 21st Century*, published in September 2011

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the International Integrated Reporting Committee (IIRC) discussion paper *Towards Integrated Reporting: Communicating Value in the 21st Century*.

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council (FRC). As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure that these skills are constantly developed, recognised and valued.
4. ICAEW has for some years had a substantial programme to support sustainability in business, particularly recognising the vital role of accountants in achieving this goal. Our 2004 report *Sustainability: the Role of Accountants* is widely regarded as a pioneering work in the field. We provide guidance on measuring, reporting and assuring sustainability information. We worked with the Environment Agency to produce the authoritative report *Environmental Issues and Annual Financial Reporting* (2009). We also provide e-learning resources on corporate responsibility and the issues facing businesses in becoming sustainable. To support members working with SMEs, we are developing an online resource centre to help businesses engage with sustainability issues at a strategic level. ICAEW hosts events that ask challenging questions about sustainability and business. Central to this work is the Finance Innovation Lab, jointly hosted by ICAEW and WWF-UK. This has created a place where people with good ideas about how to change the financial system can get together and put their ideas into practice. A wide range of initiatives has emerged from the Lab process. These include a project, funded by the Calouste Gulbenkian Foundation, to examine the most promising policy ideas on how to overcome some of the biggest barriers to a sustainable economy. Members of the ICAEW Sustainability team are also members of the Social Return on Investment Board, the FTSE for Good Policy Committee and the Climate Disclosure Standards Board.

COMMENTS ON THE DISCUSSION PAPER

MAJOR POINTS

5. We welcome publication of the discussion paper. We believe that it raises important questions about the future of business reporting and takes some useful initial steps towards addressing them. As the IIRC no doubt recognises, much work still needs to be done to develop the ideas in the discussion paper and there are some significant respects in which the thinking underlying its proposals needs to be clarified. In particular, it is not clear to us what the IIRC means by 'creating value', as discussed below. We stand ready to assist the IIRC in addressing these outstanding questions and in taking forward this initiative.
6. Where in these comments we refer to 'integrated reporting', we refer to the particular form of reporting proposed in the discussion paper. There are of course many ways in which the different strands of business reporting could be integrated, and where we question the discussion paper's proposals this does not mean that we think business reporting should not be integrated.

7. The IIRC's approach, which is aimed initially at larger companies, is only likely to succeed if it attracts extensive support from business and investors. At the moment, while we would hope that many larger companies and investors will endorse the proposals in the discussion paper, we do not think that the case made for integrated reporting is sufficiently compelling to command the strong and widespread support desirable from these two key groups. Real improvements in communication might flow from the proposals in the discussion paper, and we are keen to ensure that these improvements are realised. This will however require reporting entities to be significantly more transparent than they are now, particularly as regards the disclosure of non-financial information. For this reason, many organisations are likely to find the proposals challenging when they try to apply them in earnest. The experience of companies engaged in the Pilot Programme will be of great interest in this respect and we would welcome some early indication of the preliminary results.
8. The discussion paper assures readers that the information to be provided by integrated reporting is just what investors seek, but the evidence for this is not really brought out. If the proposals are indeed to be helpful to investors, and to gain their support, they will have to lead to fresh disclosures that investors regard as relevant to their understanding of the business and its prospects. It would not be particularly helpful simply to reorganise existing disclosures or merely to claim that reporting has been integrated if the interconnections between its different elements are not made abundantly clear.
9. We suspect that there could be some strong early interest in applying the proposals from organisations such as governmental bodies (eg, in the UK, local authorities) and not-for-profit bodies, as opposed to businesses. Extending the proposals to other audiences emphasises the importance of clarifying what is meant by 'value creation'. We look further at this point in our comments on Question 6 on multiple capitals.
10. Although much work remains to be done in developing the proposals in the discussion paper, they sometimes read as though the concept of integrated reporting is already fully thought out, rather than a work in progress in its early stages. This may be essentially a presentational matter, but we think it would make future proposals more acceptable to those who still need to be persuaded of their merits, if they could be expressed in a way that indicates more clearly that we do not yet have all the answers.
11. The proposals should perhaps be seen as a vision of how business reporting might ultimately develop. Such a vision may well be useful in inspiring preparers to experiment with their own reporting. However, if it is intended that businesses should in due course adopt the vision as their own, then some sort of roadmap will be needed to show the practical steps by which they can reach the ultimate destination, starting from where they are now. Such a roadmap may well vary from one jurisdiction to another, and so may be difficult for the IIRC to develop on a global basis.
12. We like the examples given in the discussion paper. They do not provide a complete version of what integrated reporting will look like, and so emphasise that it is still at the experimental stage.
13. The discussion paper lists a number of challenges that have yet to be resolved (page 21), such as directors' liability and commercial confidentiality. We applaud the efforts of the IIRC to identify and draw attention to these challenges, and would only add that they are indeed significant issues, which companies experimenting in this area no doubt encounter already. Businesses preparing integrated reports will face difficult choices in deciding, for example, how far proposed disclosures are compatible with safeguarding their competitive position, especially if the proposals are not implemented on a truly global basis. There are also some important unresolved issues that have not been explicitly addressed in the discussion paper, such as the place of the financial statements – which will remain very important, in our view - in an integrated reporting environment.

14. Indeed, although integrated reporting is intended to provide a comprehensive form of reporting for businesses, it is important to recognise that no framework can hope to cover all the information that businesses provide to their various stakeholders, still less to satisfy stakeholders' information needs in their entirety. The market for information about businesses is necessarily fluid and constantly evolving in a way that is beyond the control of any regulatory authority or standard setter, even a global one. We have explored these issues in our Information for Better Markets report, *Developments in New Reporting Models* (2009). This can be accessed at www.icaew.com/bettermarkets.
15. We believe that the Pilot Programme will provide useful experience that can be drawn on in developing the IIRC's ideas. Although the IIRC has indicated that it plans to issue an exposure draft next year, this may prove premature. It would probably be better to wait until further experience from the Pilot Programme can be reflected in its thinking.

SPECIFIC QUESTIONS

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?

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

16. It is not clear to us what the discussion paper means by 'value creation'. Presumably it is not the same thing as making a profit, but it would be helpful to clarify what it is, as we discuss below under Question 6.
17. It will always be possible for businesses to improve their reporting. The relevant questions at a general level are: Will a particular proposal lead to better reporting? And if so, will the benefits of the proposal exceed its costs? If we simply ask, 'Can things be improved?' the answer must always be 'Yes'.
18. Other issues that it would be useful to consider are: What are the obstacles to implementing a proposed improvement? Why to date have companies not adopted it? Is it because there is no demand for the information? Is it because of regulatory obstacles? What incentives do businesses need to persuade them to improve their reporting?
19. While the proposals in the discussion paper are potentially global in scope, we suspect that they will be more or less attractive in different countries. We believe that each country is likely to have its own views on how best to achieve the goal of integrated reporting. A global, top-down approach is unlikely to be successful. We therefore encourage the IIRC to be as inclusive as possible in seeking involvement and input from, for example, developing countries and those with very different legal and political frameworks to those of Western democracies, for example China or Vietnam.

Towards Integrated Reporting

Question 2

Do you agree with the definition of Integrated Reporting on page 6? Why/why not?

20. We do not think that reaching agreement on a definition of 'integrated reporting' is likely to be critical. What matters is the substance of the proposals and their development through experimentation in practice.

An International Integrated Reporting Framework

Question 3

Do you support the development of an International Integrated Reporting Framework? Why/why not?

21. We consider the framework set out at pages 12-15 of the discussion paper is good enough to be going on with and provides preparers who want to experiment with a sound basis for doing so.
22. Beyond this, it is not clear what ‘the development of an International Integrated Reporting Framework’ would imply. Would it be something like the conceptual frameworks that exist for financial reporting, developed by standard setters to govern (in some sense) their own activities? Would preparers be free to depart from the framework, or would it be mandatory? If mandatory, who would it apply to and who would enforce it? How would its status differ from that of other proposals for integrated reporting? We think that these and perhaps many more questions remain to be addressed, particularly where the paper is somewhat self-contradictory; for example, is integrated reporting a revolution, replacing all existing reporting, or is it an evolution, building on existing reporting? If the latter, how will that work?

The way forward

Question 4

(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?

23. As noted above, we are not convinced that the discussion paper’s proposals are framed in such a way as to command widespread support among larger companies and their investors. Although we understand that a promising number of large companies have shown interest in the Pilot Programme, we suspect that other types of entity, such as government bodies and private sector not-for-profits may be promising candidates for integrated reporting because of their inherently wider view of accountability to stakeholders.
24. Extending the proposals to other audiences, however, emphasises the importance of clarifying what is meant by ‘value creation’. Whatever it means for businesses, it presumably means something different for not-for-profit organisations, whether in the public or the private sector. We believe this is a crucial issue requiring wider debate.

Business Model and Value Creation

Question 5

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?

25. We are unable to answer part (b) of this question fully until, as noted above, it is clarified what the IIRC understands by ‘value creation’. However, whatever its exact meaning, we believe that the discussion paper needs to balance its focus on the future with a recognition of the value of information about the past. No doubt the future is what everybody would like to know about, and in some important respects – such as the going concern assumption and consideration of asset impairments – ‘historical’ financial information also looks to the future.
26. But there are good, practical reasons why much business reporting focuses on the immediate past. One reason is that it is important that agents should be accountable for their actions. They are made accountable by reporting on their past actions. While this may seem to be

backward-looking, the knowledge that they will be accountable for what they do is a powerful force governing agents' future conduct. A second reason is that information about the past provides a good basis for developing forecasts for the future. The future will be different from the past, but not so different that knowledge of the recent past is irrelevant and hence unworthy of focus and analysis. Reporting on recent performance also allows users to judge the accuracy of their own previous expectations. In these ways 'historical' information provides an anchor for forecasting future performance. A third reason is that information about the past is checkable by a third party (eg, by auditors). Information about the future is inherently subjective and uncertain, and there is a risk that it can deteriorate into empty boasting about achievements that may never materialise unless it is anchored to past performance. This is not of course to suggest that it is impossible to devise useful forms of assurance on forward-looking information, but the nature of the assurance that can be given will have to reflect the underlying uncertainties.

27. Disclosure of the business model is a new requirement for listed companies in the UK. We are not aware of the same requirement in other jurisdictions. It remains to be seen how useful the new disclosures in the UK will be. While the business model is on the face of it a sensible point on which to focus, it is still quite a novel topic as a subject for business reporting, so experimentation will be useful. There is perhaps some confusion among companies about what may be required by way of disclosure about their business model, or even what a business model is. In this context, the Financial Reporting Council's 'Financial Reporting Lab', recently established in the UK, may be a fruitful arena in which to develop guidance or best practice in this area.

Question 6

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

28. We think that the concept of multiple capitals is helpful as an indicator for preparers of what they are accountable for, and therefore of the sort of issues that they need to address in their reporting, in some cases probably by providing relevant key performance indicators (KPIs). We do not think that too much weight should be put on them as precise concepts, and the six types of capital identified are clearly very different in terms of, for example, whether they are resources that belong to the business and whether they are measurable. Where the capital itself is not measurable, there may still be relevant KPIs that could be disclosed.
29. When in due course it explains the concept of value creation, it would seem natural for the IIRC to link it with the different capitals. We would expect that value creation would be associated with an increase in a particular type of capital and value destruction with a decrease in capital. Different users of corporate reporting will of course be interested in different capitals. We would expect investors, for example, to be primarily interested in financial capital. Natural capital may be a difficult category to report on as it may not be clear to any particular organisation what its impact is on resources that are widely distributed across the planet and which it does not own. It will be important that the links between each of the capitals and profitability (or whatever value creation might mean for the reporting organisation) are explained.

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?

30. As stated above, we are concerned that integrated reporting could be too strongly focused on the future, and we therefore question 'Future orientation' as a guiding principle. Considerations of accountability and reliability are likely to mean that a significant focus on the past should

continue, though – as we note above – information about the past provides a good basis for developing forecasts for the future.

31. The ‘Responsiveness and stakeholder inclusiveness’ principle also seems to us to be a rather doubtful one. In general, the report emphasises that integrated reporting will be useful for investors. There is a tension between this approach and one that emphasises stakeholder inclusiveness. This issue needs to be resolved.
32. We believe that more stress needs to be placed on ‘reliability’, especially where this can be supported by some form of third party assurance. We are concerned that without this, there is a danger that integrated reporting will tend too much towards unsubstantiated statements. This would discredit the whole process.

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?

33. It is not clear enough yet how the ‘Performance’ content element would work in practice. Perhaps this is a point that could be developed in the light of experience with the Pilot Programme. This links to our concerns about downplaying the importance of past performance information and reliability of information.
34. Also, appropriately given the object of the exercise, there are several references to information being integrated. Without examples of how this will be done, it is also unclear what this will mean in practice, and again the Pilot Programme should be helpful.

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?**
 - (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?**
35. ICAEW is examining the principles of integrated reporting in the context of its own annual report. For some organisations it may be tempting to reorganise existing disclosures and to claim that this is integrated reporting. But it is already clear from our work to date that a conscientious application of the principles of integrated reporting requires considerably more than this and that it poses real challenges for preparers. One aspect of this for a not-for-profit organisation is the concept of ‘value creation’ and how this can be given real meaning in a way that will provide users with new and helpful insights and information.

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?**

36. We do not think that the objective should be to introduce mandatory requirements for integrated reporting. Instead, the immediate goal should be to encourage experimentation in the Pilot Programme, and then to reflect on and publicise what has been learned from this. As stated earlier, we think that 2012 may be too soon for an exposure draft, though it would no doubt be useful for the IIRC to report on the comments that it has received in response to the discussion paper and how it intends to reflect them in the development of its work.
37. In our view, the IIRC should also redouble its efforts to engage with the sceptics who no doubt remain to be convinced of the merits of integrated reporting and, as part of this exercise, developing a case for it that will be highly persuasive for large businesses and their investors. This outreach effort should include organisations in countries that have not played a prominent role to date in the IIRC's work.
38. Because we do not see integrated reporting as something that should be forced on organisations through mandatory requirements, we do not believe that harmonising reporting requirements within and across jurisdictions should be a priority for the IIRC. Indeed, as it is difficult at this early stage to determine exactly what the IIRC's future role should be, we believe that it would be premature to think in terms of developing permanent governance arrangements. The experience of the IFRS Foundation over the past ten years has pointed to the need for constant adaptation of the organisation's governance as the role and global importance of the IASB has evolved. However, we agree that appropriate accountability will be critical as the IIRC seeks support for its proposals over the next few years and we would welcome being involved in some initial consultation on how best to achieve this.

Question 11

Do you have any other comments that you would like the IIRC to consider?

39. There is very little in the paper about audit and assurance. It will be important to develop these aspects in conjunction with the auditing profession and/or other possible providers of assurance.
40. Although, as we have noted, the nature of the assurance that can be given on different types of information varies, it should be possible to provide some sort of assurance opinion on any information where, firstly, there are suitable principles for organisations to follow, leading to reports that are credible and broadly consistent, and, secondly, the recipients of the opinion are a defined group or groups. It will, therefore, be important to understand better who the users of integrated reporting are intended to be. Work will also be needed on appropriate forms of assurance reporting.
41. We have indicated that we believe the way forward for integrated reporting for the foreseeable future is through voluntary adoption and experimentation, and it would be sensible to proceed in the same way in developing assurance on integrated reports. ICAEW is currently developing a framework for selective assurance reporting on narrative information in the annual report and this may well be helpful in relation to integrated reporting as well.

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