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Dear Professor King

Consultation Draft of the International <IR> Framework

We would like to thank you for the opportunity to provide the International Integrated Reporting Council (IIRC) with our comments on the Consultation Draft of the International <IR> Framework.

The IDW is pleased to be able to contribute to this important initiative. We welcome the IIRC's efforts to evolve corporate financial reporting. We consider it to be particularly important that the prerequisites for reporting useful to users be set forth in the Framework so that integrated reporting does not degenerate in a mere marketing exercise. In particular, it is critical that the Framework clarify that entities will need systems, processes and internal control to enable management to capture and document the evidence supporting the content of integrated reports, process the resulting information, and report it in integrated reports in a reliable fashion. We note other important issues in this respect in our responses to the questions.

Our answers to the specific questions are as follows:

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

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

We appreciate the principles-based approach of the <IR> Framework. However, the principles have to be sufficiently clear to provide for consistent, comparable

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and concise reports. We recognize, given the wide variety of entities to which the Framework would apply, that fixed, detailed reporting criteria, such as in IFRS, would be counterproductive. Suitable criteria are necessary to provide a basis by which management and those charged with governance are able to substantiate their decision for including or excluding certain information from the different parts of the integrated reports.

An additional principle ought to be that the nature of the information provided based on the application of the suitable criteria ought to be capable of being subjected to evidence-gathering procedures. If management makes assertions in integrated reports without evidence to support those assertions, then there is a danger that integrated reports will not contain objective analyses required by users of integrated reports.

It is stated in paragraph 1.13, that “senior management and those charged with governance (...) need to collectively exercise judgement to determine which matters are material.” Reference might be made to the Guiding Principle “Stakeholder Responsiveness” (Section 3C).

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 (paragraphs 1.18-1.20).

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

No. We believe that today there are three important developments in corporate reporting, which impact each other and therefore have to be looked at simultaneously. These are conventional financial reporting (e.g. according to IFRS/national GAAP), sustainability reporting (in particular according to G4) and integrated reporting (according to the <IR> Framework).

We acknowledge that integrated reporting is about expressing the company's unique value creation story and that it focusses on providing only the most useful information to providers of financial capital through focussing on opportunities and risks and waiving compliance-driven reporting on structures and systems, which tend to not change over time, but are regularly required under financial reporting standards. Therefore, integrated reporting competes with exist-

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ing financial reporting standards rather than with existing sustainability standards. We understand that many NGOs fear that companies might produce integrated reports and simultaneously give up sustainability reporting because integrated reporting is often misunderstood as being more about sustainability reporting than about better and more complete financial reporting. We recommend clarifying this in paragraphs 1.18-1.20.

Although we are aware that current financial reports (prepared in accordance with IFRS/national GAAP) do not meet the requirements of the Consultation Draft International <IR> Framework, we believe it would be useful for the IIRC to clarify, whether and under which conditions a financial report can be prepared in accordance with IFRS/national GAAP and the <IR> Framework – or whether an integrated report according to the <IR> Framework must be separate from the traditional financial report.

As one of the main motivations for founding the IIRC was that traditional financial reporting is too complex and compliance driven, the IIRC should also try to impact financial reporting standard setters to question their standards against the background of the <IR> Framework. E.g., we believe that the current European Commission's proposal for a non-financial statement to be included in the 4th and 7th Accounting Directive will lead to more quantity but not necessarily a better quality of corporate reporting.

A key question is how management and those charged with governance will deal with accountability issues arising from information included in integrated reports that were extracted from other reports (e.g., financial statements, management report, sustainability reports, compliance reports, etc.) due to the fact that the systems that generate the different information in these reports may be different and therefore be subject to different accountability arrangements within the organization. This may result in the information extracted from some reports being of greater reliability than that from other reports, and the resulting difficulties for internal assurance through internal control (e.g., due to different materiality levels). This also becomes a serious issue in relation to the use of the work of other assurance practitioners by the assurance practitioner responsible for assurance in relation to information in the integrated report when external assurance is desired.

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Question 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?

We believe that referring to internationally accepted reporting standards will help improve the comparability of companies' non-financial disclosures provided companies have already identified the relevant non-financial aspects of their business.

For companies, especially SMEs, which have not yet assessed which non-financial aspects of their business have a material impact on their financial situation, it might be helpful to have a (limited) set of (sector-specific) indicators which are empirically proven to be relevant to companies' situation. However, this might result in companies working through these recommendations as if they were a checklist, just disclosing certain information without assessing, whether the "required" information is material at all, while other, relevant information is not disclosed just because it is not perceived as required by the recommended standard.

This might be solved by referring to a (small) set of indicators and "softly" recommending this as a point of reference on the IIRC website (not in the Framework) to give an "idea" as to which aspects might be relevant. It should be made clear, that

- (1) companies should assess which KPIs are relevant in their individual circumstances and why,
- (2) the enumeration is non-exhaustive, which means that more aspects might be relevant and that the company will need to assess this.

Therefore, IIRC should only make references to existing standards that include suitable criteria against which the company has to assess whether a KPI is relevant or not.

We agree with the statement made in paragraph 3.50, that if a company chooses to report KPIs in its integrated report, it should be the same KPIs that might be used in an underlying financial or sustainability report. Therefore, GRI G4 might be one source of reference. Others might be the SD-KPIs by SD-M, the Sustainability Accounting Standard of the Sustainability Accounting Standards Board or the ESG-KPIs by DVFA/EFFAS. The United Nations Principles on Responsible Investment (UN PRI) and the United Nations Global Compact (UN GC) are – in our view – too generic. However, any framework to be referenced must meet the following criteria: relevance, reliability, neutrality and un-

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derstandability such that the criteria are suitable. Furthermore, such frameworks must clarify that adequate evidence is the basis for assertions made by management in their respective reports.

Question 4: Please provide any other comments you have about Chapter 1.

We welcome the statement that financial capital providers are the primary intended users for integrated reports (paragraph 1.6). Although we are aware that this is being criticized by other stakeholders, we agree with the IIRC's conviction to stick with this – for two reasons:

(1) If the integrated report were a “multi-stakeholder report”, there would be a danger of information overload and such a broad report – in our view – could not be efficient. We believe that especially providers of financial capital might then not use such a report. Thus, integrated reporting would not impact (financial) capital allocation decisions.

(2) We believe, that the danger that companies might move away from sustainability reporting to integrated reporting (see our answer to Question 2) would be increased if all stakeholders were defined as the audience for the integrated report. However, we recommend including stakeholder expectations into the materiality assessment.

Although we believe that all stakeholders will benefit from integrated reporting, we do not (fully) agree with the statement in paragraph 1.7 (repeated in paragraph 2.38), as we do not believe that the major benefit for stakeholders will come through the integrated report and other communications: Stakeholders will rather benefit from integrated thinking, which is the prerequisite for an integrated report and which is likely to lead to better resource allocation, i.e. better allocation of the six capitals.

We agree with the statement made in paragraph 1.8, but we should like to see included, that integrated reporting might encourage providers of financial capital away from short-termism to take a longer view.

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).

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

Yes, we agree. We believe that the six-capitals-approach is widely accepted. Moreover, we believe that it is a useful categorization for assessing on which inputs a company relies and what the outcomes of its business activities are. Hence, the six capitals will assist integrated thinking.

However, we believe that the concept is not yet sufficiently clear. We also believe that an integrated report needs to depict not only the “stock” (that is the capitals), but also the “flows” – that is, the value streams creating capital and being generated from the use of capital (or converse, negative value streams deteriorating capital or being generated from the use of capital). We ask the IIRC to clarify this.

Question 6: Please provide any other comments you have about Section 2B?

The examples given on the interdependencies of the capitals (e.g. in paragraph 2.13) are, in our view, too positive: Experience shows that companies are generally not reluctant to report such win-win-situations. We recommend including one or more examples, where there is a trade-off, i.e. where one stock of capital increases while another decreases.

The descriptions of financial capital and manufactured capital in paragraph 2.17 remind us of a company’s assets and liabilities, as shown in the balance sheet and further described in the notes. We wonder, in how far the reporting on these two capitals in the integrated report will differ from the afore-mentioned elements of conventional financial reporting and in how far they will coincide.

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).

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

More yes than no: We believe that defining a business model as a system of inputs, business activities, outputs and outcomes will – as the capitals will – foster integrated thinking.

However, we recommend eliminating the word “chosen”. This might affect integrated thinking, as senior management might only consider those aspects of the

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business model that they *actively* chose. We believe, that inputs, business activities and outputs are regularly actively chosen by senior management, whereas outcomes – especially negative externalities – generally are not being taken into consideration when making business decisions and are therefore not actively chosen, but are rather perceived as a by-product of the business model. We are convinced that eliminating the word “chosen” will not affect the sense of the definition.

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).

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

Yes, because this definition of “outcomes” logically bonds the definition of “business model” to the concept of the capitals. For this reasons, we believe that outcomes should be related to the relevant value streams.

Question 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 recommend amending the last sentence in paragraph 2.43 to read as follows, or similar, to clarify how a company’s non-financial performance impacts its financial performance: “[...is unlikely to maximize value in the longer term], because once such misbehaviour gets public, stakeholders – especially customers – will consider this in their (buying) decisions and purchase another companies’ goods/services.”

Question 10: Please provide any other comments you have about Chapter 2 that are not already addressed by your responses above.

Paragraph 2.3 states that material elements of value creation should be measured “where practicable”, whereas paragraph 2.10 states that the organization needs to set up measurement and monitoring systems. We believe that measuring elements of value creation is essential and always practicable, at least on an ordinal scale (e.g. “more/less than last year”) or, failing that, on a nominal scale under measurement theory (classification of different kinds of outcomes or inputs). We believe that what is meant in paragraph 2.3 is that material elements

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of value creation should be described, and reported *quantitatively* where practicable, and otherwise at least classified. We suggest the IIRC clarify this.

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

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

No, we do not agree. Materiality is a well-established concept in accounting and auditing (it is defined in IFRS and US GAAP, for example, and also by auditing standards – see ISA 320). Although the nature of some of the information to be presented in an integrated report differs from that for financial statements, it may be useful to have a definition align the concept more closely with that used by accounting and auditing standards than has been proposed in the wording of the definition in paragraph 3.23. However, there are two issues that have been identified with the definitions used by accounting standards: 1. At variance with the definition in auditing and assurance standards, they do not include omissions as misstatements, and 2. they double up on the probability threshold by using the word “could” in connection with “reasonable expectation”. For these reasons, in our comment letter to ESMA’s consultation paper on materiality, we had proposed the following definition for financial reporting:

“Misstatements, including omissions, are considered to be material if they, individually or in aggregate, are reasonably expected to influence the economic decisions of users taken on the basis of the financial statements as a whole.”

In addition the IIRC definition does not consider the interaction of information – i.e., information alone may not be material, but it may be so in conjunction with other information (the aggregation aspect noted in the financial reporting definition). It is also unclear to us whether information in the integrated report would be considered material on its own or in relation to the integrated report as a whole. Transposing this definition to the IIRC definition so that the word “could” is deleted and to take into account the aggregation issue, the IIRC definition would read:

“A matter is material if, in the view of senior management and those charged with governance, that matter is, either individually or in conjunction with other information in the integrated report, of such relevance and im-

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portance, such that it is reasonably expected to influence assessments of the primary intended report users with regard to the organization's ability to create value over the short, medium and long term [taken on the basis of the integrated report as a whole].

As noted it is still unclear to us whether materiality is to be considered in relation to the integrated report as a whole. This may depend upon the objective of integrated reporting.

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

We have no further comments about Section 3D or Section 5B.

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

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

The matters that we note in our introductory section are key to the reliability of integrated reports, in particular that the Framework clarify that entities will need systems, processes and internal control to enable management to capture and document the evidence supporting the content of integrated reports, process the resulting information, and report it in integrated reports in a reliable fashion. Furthermore, without suitable criteria, it is not possible to capture and generate reliable information.

We would also like to emphasize the importance of external assurance for the credibility of integrated reports, including improving the reliability of reports and preventing integrated reports from being misused as marketing brochures. Obtaining an assurance conclusion on integrated reports will be challenging, but we believe that assurance practitioners are ready and prepared to take on this challenge. However, we would like to emphasize that assurance will only enhance an integrated report's credibility, if the assurance practitioner fulfils certain criteria, which are (1) independence, (2) compliance with a professional ethical framework (3) undergoing of firm level quality control procedures and external quality assurance, and (4) adherence to generally accepted and transparent assurance standards. We believe that these criteria should also be included

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in the <IR> Framework. However, the IIRC should not develop any assurance standards, but leave this to established standard setters, primarily the IAASB.

Question 14: Please provide any other comments you have about Chapter 3 that are not already addressed by your responses above.

We have no further comments about Chapter 3.

Question 15: Please provide any other comments you have about Chapter 3 that are not already addressed by your responses above.

We generally agree with paragraph 3.49, however, in our view, companies should also be obliged to define KPIs in their integrated reports.

Question 16: Please provide any comments you have about Chapter 4 that are not already addressed by your responses above.

We welcome the IIRC's approach to clarifying what is to be reported by asking questions, as we believe this will help companies to apply the International Integrated Reporting Framework.

Although paragraphs 4.2, 4.3 state that the integrated report needs not to be sequenced as the Content Elements are sequenced in paragraph 4.1, we believe that companies will often use this as a first idea as to how to structure their (first) integrated report. As a company's business model is at the core of integrated reporting, we recommend the following sequence: A Business model, B Organizational overview and external environment, C Governance, D Strategy and resource allocation, E Performance, F Opportunities and risks, G Future outlook.

We recommend amending paragraph 4.33 to read as follows or similar: "Taking into account its opportunities and risks, what challenges and uncertainties..."

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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>.

Question 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, there should be such a requirement, because integrated thinking can only be implemented in a company if those charged with governance support and adopt this way of thinking. Moreover, it is also important to hold management accountable for the information provided.

Question 18: Please provide any other comments you have about involvement of those charged with governance.

We would like to emphasize that independent external assurance is a crucial element of corporate governance. Those charged with governance will best oversee and control a company if they work closely together with the assurance practitioner.

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

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

Assurance should cover the integrated report as a whole to the extent practicable – otherwise there would be uncertainties and the expectation gap about the work the assurance practitioner actually performed would possibly increase. We note our responses above that specify the need for adequate systems and processes, suitable criteria, adequate evidence and resolution of the use of the work of other practitioners so that such assurance is feasible in theory and practice.

Moreover, we should like to emphasize that if the integrated report, as a company's primary report, were to include extracts from other underlying reports, the extracts from these underlying reports would need to have been subject to an assurance engagement with the same level of assurance as that pertaining to the integrated report. In addition, those extracts would need to have been subject to assurance using the same materiality levels applied to the integrated re-

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port. As noted above, it is still unclear how the use of the work of other practitioners should be resolved.

Question 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 do not believe that the Framework provides suitable criteria for an assurance engagement, nor does the Framework require adequate evidence or the needed systems or processes as a basis for management assertions in an integrated report. These problems are not limited to expressing an assurance opinion on integrated reports (see our preface to this letter). Without such criteria and adequate evidence, two similar companies might prepare very different integrated reports and both claim to be in accordance with the <IR> Framework.

Question 21: Please provide any other comments you have about Chapter 5 that are not already addressed by your responses above.

We have no further comments about Chapter 5.

Question 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?

We highly appreciate the IIRC's efforts so far. We believe, that its work will assist companies in challenging the way they create value, in identifying the material value drivers and in improving governance through integrated thinking.

Question 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?

We are not sure whether further explanatory material is necessary – we believe that this will become clear over time and, at this early stage, the Pilot Organizations will be best placed to respond to this question. If suitable criteria are developed and the need for adequate evidence is covered, this might be sufficient

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to assist companies in applying the Framework and preparing an integrated report. However, as noted above, this does not resolve the accountability and assurance issues arising from the extraction of information from other reports into the integrated report.

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

We have no further comments.

We would be pleased to answer any questions that you may have in relation to our comments.

Yours sincerely

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