AFM

International Integrated Reporting Council
submitted via
http:/www.theiirc.org/consultationdraft2013/feedback/

Date	15 July 2013
Our reference	TFV-AEDr-13070734
Page	1 of 5
Phone	020 - 797 37 21
E-mail	fin.verslaggeving@afm.nl
Concerning	AFM response to the Consultation Draft of the International <IR> Framework

Dear members of the IIRC,

The Netherlands Authority for the Financial Markets (AFM) appreciates the opportunity to comment on the Consultation Draft of the International <IR> Framework (Draft Framework) as issued on 16 April 2013.

The AFM is the independent financial market and business conduct regulator for the savings, lending, investment and insurance markets in the Netherlands. The AFM's strategic objectives are to supervise the fair and efficient operation of the capital markets, to promote the provision of financial services with due care and to contribute to the stability of the financial markets. In particular, the AFM enforces the rules for the issue of securities and public offerings, for financial reporting, and for audit organisations responsible for auditing financial reports.

Integrated reporting aims to contribute to a more sustainable economic environment. It may be beneficial for companies to apply integrated reporting. Firstly, early adopters of integrated reporting will benefit from being a first mover; the right focus now will create a better foundation for future business operations. Secondly, integrated reporting contributes positively to the brand name of the company; this becomes more and more important for the buyers of products and services.

Currently, investors focus too much on comparing financial performance (between companies) and growth expectations (between countries) when deciding how to allocate their resources. There is a major risk that investors put not enough weight on ESG risks. Therefore, countries that price externalities by levying tax or excise and subsequently re-invest the proceeds in sustainable projects, will be put at a disadvantage. This would not be right, because in the long run taking into account ESG risks will result in a better and more sustainable economic environment. Integrated reporting makes differences between companies and countries in relation to non-financial risks more visible. Therefore, we expect integrated reporting to be helpful for (long term) investors when deciding how to allocate their resources.

The AFM strongly believes integrated reporting is an important development in corporate reporting, enabling entities to tell their unique story about value creation. The publication of the Draft Framework by the IIRC is considered to be an important step in the development of combining strands of reporting (financial, management commentary, governance and remuneration, and sustainability reporting) into a coherent structure that communicates the full range of factors that materially affect an organization's ability to create and sustain value.

Further, the AFM believes market participants should have the lead in the development of integrated reporting, whereas security regulators should stimulate the development of integrated reporting. The AFM expects enforcement will become relevant in a next phase, by the time integrated reporting is more mature.

By issuing the Draft Framework, the IIRC wants to enhance transparent corporate reporting to provide a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term. In this respect, we feel that the goals of the IIRC align with one of the main AFM's objective: to promote a transparent, fair and orderly operation of financial markets.

The AFM supports the developments with regard to integrated reporting, and the implementation and adoption of integrated reporting frameworks, such as the Draft Framework, by companies in their annual reporting. As announced in 2012, the AFM currently conducts a baseline assessment on the current practice of integrated reporting by listed companies in the Netherlands.[1] The AFM will use the results to follow the developments on integrated reporting and to be able to participate in the (global) debate on integrated reporting.

In this letter we set out our high level observations to the Draft Framework.

General comments

The AFM is generally supportive to the goals the IIRC want to achieve by developing an integrated reporting framework. In this respect, the AFM has the following general remarks and comments on the Draft Framework.

- The Draft Framework is responding to changing expectations from a broad group of stakeholders regarding corporate social responsibilities and related transparency. Investors and consumers both demand more sustainable business practices and more transparency regarding non-financial information on strategy, business model, environmental and social impact. Successful implementation of an integrated reporting approach depends on the company's awareness of the future importance of integrated reporting and the quality of and transparency on their internal control environment (financially, strategically, operationally and their compliance with laws and regulations).
- The AFM acknowledges the role of integrated reporting in enhancing corporate transparency. The Draft Framework is a sensible approach towards further development of integrated reporting. In particular, we

[1] http://www.afm.nl/en/professionals/afm-actueel/nieuws/2012/sep/toetsing-jaarverslagen.aspx

embrace the integrated approach of strategy, sustainability, corporate governance and risk management. Further, we appreciate the selected purpose of the Draft Framework in helping companies to determine how to communicate their unique (sustainable) value proposition in a meaningful, balanced and transparent way.

- The guiding principles, such as the ones on materiality and aggregation, are likely to be a good fit with similar concepts developed in financial reporting. Due to its conceptual approach, the framework can be combined with reporting standards and frameworks as IFRS and GRI.
- Regarding the credibility and acceptance of the framework, it is important that the IIRC has a well established governance structure and is accountable and transparent on its activities and funding. The AFM recommends the IIRC to work on these issues after completion of the integrated reporting framework.

Principles-based versus rules-based approach
The requirements of the Draft Framework are principles-based. The AFM supports the principles-based approach, which will encourage companies to tell their individual and unique story of value creation. It also will help avoiding a 'checking the box' mentality in applying integrated reporting. However, the AFM would like to point out that guiding principles might impose a risk that organizations present themselves in a favorable position by making a biased assessment of whether a matter is material, and possibly mislead stakeholder's perceptions. Nonetheless, the AFM is of the opinion that this first draft of the Draft Framework provides a solid starting point for integrated corporate reporting.

The AFM agrees that this first version of the framework should not contain the duty to report specific non-financial KPIs (paragraph 1.13). Although, from a regulator's point of view, the comparability, consistency and transparency of integrated reports should be guaranteed to a sufficient level. We do understand that introduction of KPIs now would disincentive the careful and delicate step by step approach, making the integrated reporting sustainable, learning from good and less good practices and truly materializing substantially more management attention to sustainability considerations, which in the coming decades is so urgently needed. It could be necessary that in future versions of the framework mandatory sector-specific and sector-uniform non-financial KPIs are included. Including such sector-specific and sector-uniform non-financial KPIs would also enhance the enforceability of the integrating reporting framework.

Measurability, comparability and connection to other frameworks and standards
When combining different strands of reporting (financial, management commentary, governance and remuneration, and sustainability reporting) into a coherent structure, the alignment of definitions originating from various reporting frameworks or standards is important. In this respect, the AFM has the following remarks and comments in response to the Draft Framework.

- In the Draft Framework materiality is defined as relating to matters that have such relevance and importance that they could substantively influence the assessments of the primary intended users with regard to the organization's ability to create value over the short, medium and long term. The alignment of the definitions of materiality in the Draft Framework and financial reporting standards like the IFRS may require further consideration. Where financial reporting standards limit the definition to matters that could reasonably be expected to influence the economic decisions of users, the Draft Framework takes a broader view on the impact that the information might have by using the phrase 'influence the assessments'. When the integrated reporting definition is applied to financial reporting, we therefore expect financial information to become even less concise. Alignment of this definition with the definition applied in financial reporting standards is required because the integrated reporting view also relates to financial information (paragraph 1.18).

- The time dimensions (short, medium and long term) considered in an integrated report are discussed in paragraph 5.22. However, specific guidance on how to define the time frames that relate to the short, medium and long term have not been given. To ensure consistency in time frames in the integrated report, we would propose to align with the terminology used in financial reporting, such as in the case of the definition of current (one business cycle or alternatively 12 months).

The right balance
Positive and negative information in the integrated report should be communicated in a balanced way. Because of the usual principal-agent problems it is our concern that this may be difficult to guarantee in practice. For integrated reporting the challenge will be to ensure that material negative information is being reported with sufficient emphasis and in a balanced way.

Reliability of information
In the Draft Framework the integrity and credibility of an integrated report primarily depends on the quality of the company's internal control environment. However, in the Draft Framework the compliance statement is voluntary. The AFM prefers a mandatory statement of the governing body on the elements included in paragraph 5.18.

With regard to external assurance on integrated reports, a direct role for auditors is not obvious in the foreseeable future. Firstly, the auditor is only in a position to provide additional and independent assurance vis-a-vis reporting by management. As long as management remains silent on being in control in relation to all ESG and related components reflected in its integrated report, auditors are simply not in the position to provide any additional assurance to these reports.

Secondly, many different attempts are being explored by auditors, which are welcome, though - in order to be effective - these are dependent on an extension of the scope of the internal control statements, which is needed first. So far, company's management has not given an internal control statement for every aspect of internal control (strategic, operational, compliance with law and regulation - next to the financial reporting risk). To date, the scoping of the internal control statement is limited in many jurisdictions, and for that reason it is still an institutional obstacle for auditors to provide independent additional assurance on integrated reports.

Thirdly, auditors have generally less natural commitment and technical experience in the provision of external assurance towards users with regard to non-financial data as well as forward-looking statements. It will probably take a long time to build up this knowledge.

AFM

Competitive harm and disclosure

The Draft Framework mentions in paragraph 1.11 competitive harm as a possibility for not applying all the principles-based requirements. This allows organizations to give a statement on compliance while potentially relevant information is not provided. We believe that this provision should be removed.

If you would like to discuss our views in further details, please do not hesitate to contact us.

Yours sincerely,
The Netherlands Authority for the Financial Markets

Gerben Everts
Member of the Executive Board