

## 2013 INVESTOR CRITIQUE

### Executive summary

The International Integrated Reporting Council (IIRC) asked participants of its Pilot Programme Investor Network to critique selected reports from the Pilot Programme Business Network. The aim was to understand the strengths and shortfalls of today's reporting from the perspective of providers of financial capital. In particular, the reports of 21 pilot businesses were analyzed by 14 institutional organizations. Findings of the analysis are summarized in this paper.

The reports were considered useful in the following areas:

- communicating a more holistic view of performance than otherwise found in traditional financial reports
- providing insight into such areas as strategy, risk, governance and future targets
- providing a contextual foundation for interpreting and analyzing disclosed data.

To drive ongoing improvement in Integrated reporting (<IR>), the investor critique yielded several recommendations for report preparers:

1. Close perceived or actual **information gaps** by disclosing the organization's materiality assessment process.
2. Improve the **connectivity of information** by:
  - drawing explicit links between strategy and other content elements such as external environment, performance, future outlook and business model
  - structuring the integrated report in such a way that information flows logically and linkages are clear
  - grouping related themes
  - maintaining a consistent approach across segmented discussions
  - linking content elements through an index, section headings, diagrams, process maps and navigation symbols or icons.
3. Achieve **conciseness** by:
  - favouring plain language over wordy explanations
  - limiting repetition by following a logical report structure and using internal cross references
  - using simple diagrams and summary tables to communicate otherwise detailed or intricate concepts
  - including hyperlinks to more fulsome disclosures elsewhere.
4. Improve investors' ability to assess **long term value creation** by:
  - providing a clear overview of the business model
  - drawing clear links between strategy, risks, governance and future value creation
  - addressing industry-specific matters, including trends, risks and opportunities, over the longer term
  - indicating the timeframe associated with key strategies, milestones and targets
  - ensuring alignment between the integrated report and other key disclosures, including the financial statements, management's discussion and analysis or management commentary, sustainability report, codes of conduct, policy statements and corporate presentations.
5. Maintain credibility by ensuring that report content is:
  - balanced and unbiased
  - connected and insightful, as opposed to a simple restatement of information found elsewhere
  - aligned with key messaging across other corporate communications
  - substantiated, where appropriate, by credible third-party research, projections and estimates

## Which aspects of the report would you most use in your investment analysis?

- Investors found the reports particularly useful in conveying a more **holistic picture of performance**, one that goes beyond financial statement performance alone.
- The reports also provided useful information in terms of **strategy, risk, governance, operating context and future targets**.

## In the analysis of strategy, governance and prospects, where was the report lacking?

Primary areas of concerns were in the following areas:

### 1. Poor connectivity

- Inadequate links between content elements

Limited connection between **strategy** and the **external environment, performance, future outlook, business model and opportunities and risk**

- Ineffective format
  - Scattered or illogical flow of information
  - Inadequate use of diagrams or process maps to tie elements together

### 2. Real or perceived gaps in information

- Insufficient information in areas such as governance, industry-specific issues and stakeholder engagement
- Disclosure of the materiality assessment process may clarify whether the omission of information was intentional

## Does the report tell the business story concisely? Was there extraneous information that might be better placed elsewhere?

Roughly 60% of the critiques were satisfied with the conciseness and completeness of the reports. However, investors identified opportunities for improvement in the following areas:

### 1. Further opportunity for brevity

#### *Focus on material issues*

Certain information was considered extraneous to investment decision-making and, therefore, better placed on the website or in a stand-alone sustainability report.

#### *Formatting considerations*

- Repetition might be avoided through a more logical report structure
- Certain concepts could be conveyed more succinctly through diagrams and summary tables
- Explanations could be condensed through the use of plain language
- Page count could be reduced through effective and appropriate use of hyperlinks

## 2. Quest for cohesion

- Highlight connections by using a logical structure, content index, effective headings and navigation icons
- Avoid scattered themes by grouping related information
- Maintain a consistent approach throughout the report to reduce confusion

## 3. Other

Investors raised the following concerns, albeit infrequently:

- report included a 'combined' rather than 'integrated' business story
- report was thought to include imbalanced, selective or biased disclosures
- online report format was not conducive to capturing the business story in its totality

## Does the report provide a longer term view of strategy, performance, opportunities and risks than typically presented in today's corporate disclosures?

Roughly 80% of critiques observed that, relative to traditional corporate reports, the samples offered a superior view of operating context and future strategy. Despite this positive assessment, there are clear opportunities to:

- more clearly define the timeframes associated with key milestones and targets
- continue to look beyond the short and medium term to a longer term horizon
- close the gap between **strategy** and **risks, governance** and **future value creation**
- identify assumptions associated with longer term prospects

## Are there industry-specific issues that you believe went unmentioned?

Approximately 40% of the critiques noted real or perceived information gaps. Although investors sought additional *risk-oriented* information in the first instance, there was also interest in how market trends or regulatory changes might play to the organization's strategy. Furthermore, investors sought greater insight into industry-specific matters like, for example, safety track record or results of supply chain audits.

The apparent information gap underscores the importance of Paragraph 3.28 of the Consultation Draft:

**3.28 ... The materiality determination process is required to be disclosed in an integrated report to enable the intended report users to understand how decisions to include or exclude matters were made...**

Such disclosures might serve to clarify the rationale for omitted information.

## Does the report allow an assessment of the ability to generate long term cash flow?

Responses to this question were mixed. Roughly half of the critiques reported an adequate glimpse into future cash flow viability. A further 20% indicated that the reports were at least '*on the right track*'. Finally, 30% of the critiques said the view to long term business viability was obscured by such factors as:

- real or perceived gaps in industry-specific information
- inadequate description of the business model
- uncertainty about the timeframes linked to strategies and targets
- failure to separate *growth* capex from *maintenance* capex

## Is there adequate context information to understand the reported data?

Two-thirds of the critiques were satisfied with the contextual foundation provided. This foundation included macro-level information (e.g., operating environment, market trends and regulatory factors), as well as more detailed clarifications (e.g., assumptions and methodologies underpinning performance metrics). Notwithstanding these strengths, the following reminders were offered:

- The integrated report should go beyond simply *restating* information found elsewhere to truly *synthesizing* that information. In other words, by connecting content elements, the integrated report should provide *additional insight* into the organization's ability to create value over time.
- The more connected and logically structured the contextual information, the more helpful it will be to report users.

## Did you feel the need to consult other sources of information?

The integrated report should provide a concise communication about how the organization's strategy, governance, performance and prospects -- in the context of its external environment -- lead to value creation over time. Therefore, the integrated report should be viewed not as a *replacement* for the organization's full suite of disclosures, but rather as an effective *entry point* for understanding that organization. In other words, the integrated report should supplement investors' analysis of other information sources.

Consistent with this view, investors generally agreed that the sample reports offered a solid foundation for understanding the business, but were insufficient on their own. Investors also stressed the importance of consulting independent and objective sources. This stemmed from concern that integrated reports may favour the disclosure of triumphs over challenges.

When asked for preferred sources of supplementary information, investors cited regulatory filings -- including the full financial statements and management's discussion and analysis (MD&A) -- as critical documents. Other important sources included industry reports, policy statements, site visits, sustainability reports and governance disclosures. Recognizing this 'information ecosystem', preparers of integrated reports should consider how they might:

- align key messages across the organization's suite of communications
- cross-reference or link to other internal and external information sources
- substantiate claims in the integrated report with credible third-party information