Global Compact LEAD Submission: Comments to the IIRC’s Consultation Draft of the International Integrated Reporting <IR> Framework

12 July 2013

CONSULTATION BACKGROUND

Twenty Global Compact LEAD companies are participating in the “Shaping the Future of Reporting” project, which aims to harness their collective voice and promote better alignment of corporate reporting standards, frameworks and regulations. The group’s first objective of 2013 is providing collective feedback to the IIRC on the Consultation Draft of the International Integrated Reporting “<IR>” Framework. As a Global Compact initiative, LEAD’s feedback is primarily focused on ensuring that material sustainability issues are adequately addressed1.

From April to June, Global Compact staff conducted interviews with LEAD project members on the Draft Framework. The interviews were built around three key topics: 1) overall utility of the Framework, 2) alignment with other reporting standards; and 3) materiality.

Nine companies, of diverse geographies and sectors, participated in the interview process. They included companies from Japan, South Africa, Brazil, China, Italy, Denmark, and the United States, and such industries as technology, oil and gas, pharmaceuticals, mining and metals and financial services.

This is the first draft of the submission, summarizing key points that emerged from the consultation. It is important to note that this submission is not meant to replace individual company feedback to the IIRC.

GENERAL COMMENTS

Respondents welcome the International <IR> Framework as a principles-based approach to corporate reporting. The companies interviewed affirmed that they are striving to more deeply integrate financial and sustainability issues in corporate disclosures, and the IIRC offers a principles-based framework in response to this trend.

The <IR> Framework is well positioned to address two key priorities for LEAD companies: 1) making the connection between financial and environmental, social and governance (ESG) information and 2) communicating ESG value to mainstream investors.2 The business case for sustainability can often be difficult to measure and share. Respondents affirm that integrated reporting has the potential to connect financial disclosures with sustainability in a way that makes them more relevant for a broader audience than would separate financial or sustainability reports, and that this greater level of integration

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1 The Global Compact defines corporate sustainability as the delivery of long-term value in financial, social, environmental, and ethical terms.
2 We acknowledge that neither the terms ESG or sustainability appear in the Draft Framework; however the meaning of the terms are widely understood and share the same intent as consideration of the six capitals (e.g., natural capital, social and relationship, human, etc.).
of reporting practices encourages and supports the integration of sustainability in strategic planning, decision-making and operations.

However two concerns that emerged from the LEAD consultations around the draft <IR> Framework are: 1) the risk that companies may overlook material sustainability issues when applying the current materiality determination process in the Draft and 2) that <IR> will result in creating an additional report instead of enhancing an existing financial report. These comments will be expanded upon in the “Affirmation” and “Feedback” sections of the document.

AFFIRMATION OF KEY ELEMENTS

1. The Framework offers an important step away from “tick-box” reporting practices. Respondents are pleased that the <IR> Framework does not mandate reporting against a laundry list of metrics and instead offers companies guidance on identifying those issues they deem material. Reporting fatigue was widely reported by respondents, stemming from the sense that they feel obligated (or required) to track and communicate indicators that are not material to their operations or are not of interest to their stakeholders. The <IR> Framework has the potential to alleviate this reporting burden, especially in the long-run.

2. Respondents appreciate the management-driven materiality determination and integrated thinking at all levels of a company’s operations. A deep understanding of the importance of ESG issues by senior management, and CEOs in particular, was often cited as a key reason why LEAD companies are advanced in their integration of sustainability into business practice. One welcome result from this element of the Draft will be strengthened relations between departments that were previously isolated from each other. This is a key factor that may help propel sustainability into the mainstream for both companies and their providers of financial capital.

3. The principles-based approach to the Framework is well received as an “umbrella” under which existing reporting practices can be implemented (Sec. 1.13). Respondents appreciate that the Framework and its principles do not contradict those of existing sustainability standards. The Framework’s Content Elements are organized to mirror the contents of a traditional financial disclosure (e.g., strategy, performance and future outlook), which facilitates understanding of the link between integrated reporting and financial reporting. These characteristics support uptake of the Framework by a wide range of companies. Additional guidance should be made available (outside the scope of the Framework) on how to incorporate existing standards for sustainability reporting into an integrated report.

4. The flexibility and individualized nature of the Framework should be balanced with the need for comparability. Respondents raised questions about how comparable integrated reports would be in practice, but supported the emphasis placed on comparability of integrated reports described in Section 3.51-.52. The individual need of each company to “express its own value story” should be balanced with the need to retain comparability with other companies. To support comparability, an appendix with the tools referenced in Section 3.52, such as benchmark data, ratios and quantitative indicators, would be helpful.
CONSTRUCTIVE FEEDBACK

1. Broader definition of “Providers of Financial Capital”

One concern regarding providers of financial capital as the primary intended user is that it is too narrowly defined to be used by all types of business structures (Section 1.6). To encourage uptake of the Framework among companies ranging from SMEs to publicly listed multinationals to state-owned corporations, it is important that the language surrounding “providers of financial capital” be flexible to meet their diverse needs.

2. Inclusion of Stakeholder Engagement in Materiality Determination

While respondents appreciate that ‘those charged with governance’ must ultimately decide whether a matter is material, respondents agreed that there needs to be explicit reference to stakeholder engagement in this materiality determination process. Respondents affirmed that ‘providers of financial capital’ as primary intended users focuses the design of an integrated report. However, engagement with stakeholders may allow companies to identify material issues that otherwise would be overlooked.

Integrated reporting should improve efficiency in the long-run and reduce the number of published reports.

a) Respondents repeatedly embraced the notion of being able to develop one report that combines financial and sustainability disclosures. While this may not be feasible in the short term due to regulatory requirements and a potentially lengthy implementation process, companies would like the Framework to support the idea of an integrated report not as an additional publication but rather as an enhancement of an existing financial report. The language on this issue in the Framework is not sufficiently clear [Section 1.18: “It is anticipated that a stand-alone integrated report will be prepared annually...”].

b) Respondents noted that synchronizing ESG data management with financial reporting cycles is critical to integrated reporting. However, some expressed concern about the difficulty of implementing this, when internal data management systems that track environmental and other indicators, collect information on a different timeframe from the financial reporting cycle. The Framework could be more flexible in acknowledging these practical challenges of synchronizing data management with financial reporting, at least in the short-term.

To address the feedback in 2b, a possible revision to Section 1.18 is: “It is anticipated that an integrated report will be prepared annually in line with the statutory financial reporting cycle, which may require companies to first make efforts to align internal data management systems with the financial reporting cycle.”

4. Greater Clarity on Meaning of Value

Value creation over short-, medium-, and long-term is a core concept in the Draft <IR> Framework. However, the meaning of “value” could be clarified. Section 2.41 of the Draft states: “Value
encompasses other forms of value [beyond financial] that the organization creates through the increase, decrease or transformation of the capitals, each of which may ultimately affect financial returns.” This definition does not elaborate on the ‘other forms of value’ and how they relate to the capitals. For example, creation of value with respect to one capital (financial) could easily involve destruction of value in another. Respondents expressed the need for greater clarification on the meaning of value as it relates to other capitals and welcomes the forthcoming background paper on value later this year.

5. Balancing value creation with destruction, Inclusion of long-term risks

Some respondents expressed concern that value destruction and preservation are not adequately emphasized in the Draft Framework. Although Sections 2.37, 2.42, and 2.43 state that value destruction is implied each time value creation is mentioned, the risk of value destruction in the long-term is not afforded as much prominence. In addition, the difficulty of calculating the price or cost of externalities could be used as justification to not consider an issue material.

One way to address this is to more explicitly state the time horizons of opportunities and risks in Section 4C (e.g., 4.17). This would help companies consider megatrends or long-term opportunities and risks, such as climate change, population growth, water shortage, etc. For those LEAD companies whose senior management teams already understand that long-term megatrends impact their business, systemic risks are more likely to be seen as material and included in an integrated report. However, the <IR> Draft could do more to help companies with less advanced understanding to identify these risks. That said, addressing specific risks should not be prescribed in the Framework. Respondents appreciate that the Framework allows them to identify “the issues that are most material to their own operations and strategy.”

A suggested amendment to the text in Section 4.17 to address this concern is: “An integrated report identifies the organization’s approach to any risks - be they in the short, medium or long term - that are fundamental to the ongoing ability of the organization to create value...”

6. Time Horizons

Duration of short, medium and long term varies by industry and even business cycle. A clearer definition of what these terms mean, or of how to determine them, would be helpful for applying the Framework and answering some of the questions raised in comment #5 above on materiality and value creation. The definition of short, medium and long term should take sector context into consideration.
APPENDIX:

LEAD Consultation Participants
Contributed to the submission via interview, webinar participation and written comments.

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<tr>
<th>Company</th>
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<th>Industry</th>
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<td>Brazil</td>
<td>Industrial Mining &amp; Metals</td>
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