London School of Business & Finance

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By e-mail to: dpresponses@theiirc.org 14 December 2011

Dear Sir/Madam,

Integrated International Reporting Commission – Consultation Response

Thank you for the opportunity to provide comments on the above discussion paper.

Responses to the discussion paper questions on which we are able to comment are set out below. By way of background, it is London School of Business and Finance's mission to become the first choice for business education in Europe. Through educating the world's most creative, talented and ambitious students, London School of Business and Finance aims to bridge international boundaries and provide individuals around the globe with an opportunity to achieve academic, personal and professional success. LSBF attract over 20,000 quality candidates from over 140 countries worldwide, and continues to experience exponential growth, both on-campus and online, all around the world, while continuing to develop corporate training, partnerships and associations with best-practice organisations globally.

In partnership with established and globally renowned academic partners, LSBF deliver two accredited MBA programmes and a suite of postgraduate and undergraduate business degrees (in partnership with University of Wales and Grenoble Graduate School of Business, triple accredited by AMBA, EQUIS and AACSB). LSBF is also a well-established provider of professional programmes such as the ACCA, CIMA, CFA® and CIM, and operate best practices school-wide.

The school continues to expand rapidly in response to demand from UK domestic and international students for globally accredited business qualifications and currently operates four campuses across the UK; London (Holborn and Marble Arch), Birmingham and Manchester as well as international offices in Singapore, Prague (Czech Republic), Toronto (Canada), Moscow (Russia), Hong Kong (China), Johannesburg (South Africa), Port Luis (Mauritius), Bogota (Colombia) and Almaty (Kazakhstan).

An International Integrated Reporting Commission, Committee or Council?

We begin with a small but we believe important suggestion. The acronym 'IIRC' formally stood for International Integrated Reporting *Committee*. We suggest amending that title to International Integrated Reporting *Commission* rather than 'Council'. A Commission has a task to carry out. It is highly project focused. We believe this is the way the IIRC will want to conduct itself over the coming months and years.

It is our view that the formation of the IIRC is long overdue. The world of corporate reporting presents a bleak prospect. If corporations are legal persons, then there are some worrying ailments afflicting them. They are suffering increasing infant mortality. For example, Will

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Hutton in 'Them and Us' suggests that in Britain in the 1980's a third of SME's died within three years of entering their market, and that by the 2000's the figure had jumped to a half (Hutton (2010:254). In the same passage he suggests that the average age of S&P 500 companies was forty five years in 1975; by 2007 it had reduced to eleven years. The same is likely to be the case for UK and other jurisdictions' quoted corporate stocks. And corporations are becoming increasingly myopic, as evidenced by, for example, Andrew Haldane's speech 'The Short Long' given in May 2011 in Brussels to the 29th Societe Universitaire européenne de Recherches Financieres Colloquium. A focus on how corporations describe themselves, both from year to year, but also over the short, medium and long term is therefore to be welcomed.

Q1.(a) Do you believe that action is needed to help improve how organizations represent their value-creation process? Why/why not?

Yes. There is growing empirical evidence that even those in the vanguard of corporate reporting are unclear about fundamental matters at the heart of their reporting. For example, the Accounting Standards Board surveyed a sample of FTSE 350 and FTSE Small Cap Index corporate reports in 2008/09 and, among other things, examined the way the sample described their business model. They then scored disclosure according to simple criteria out of 5. 52% of the sample scored only 2 out of 5, with 32% scoring 3 out of 5. Of the 32% they noted:

> We understood what they sell, where they sell it and who they sell it to but this generally fell short of describing the business model – that is a comprehensive explanation of how all of the different components of the business work together to generate cash

And evidence to the UK Treasury Select Committee on UK (and other) banks' stress testing models showed inherent 'optimism bias' in their contemplation of the degree of economic stress they were prepared to envisage, as well as the refusal to accept that one-off, catastrophic hazards may indeed materialise.

Finally, the most far sighted corporate reporters are coming to grips with the prospect of a carbon constrained, populated century where supply chains will be under severe pressure as global, economic rebalancing moves relentlessly forward. In these circumstances understanding how a corporation creates value over the short, medium and long term will become a valuable tool in sustainable development in a fiscally constrained landscape.

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

Yes. We believe the emphasis on an *international* scope is important. International is not the same as 'global'. We consider that there are a handful of truly global corporations in the world, where global signifies that the place of residence of a corporation is incidental to its business model. One lesson learned from the continuing banking crisis is that organisations keen to describe themselves as global in good economic times, failed in specific jurisdictions. It is better

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to view the majority of corporations describing themselves as global rather as institutions working more or less effectively internationally.

One aspect of the international scope of IIRC's work is the pragmatic recognition of certain facts of corporate life. For example, English is, for the foreseeable future, the language of business. For example, London has been a central hub for companies looking to establish an international listing with the highest standards of corporate governance. For example, many of the large mining and extractive industry corporations have grown up in regulatory frameworks and institutions very different to those present in London or New York.

And being international in scope also places a burden on the IIRC to truly engage in reporting practices outside the well-trodden Anglo Saxon axis:-

- Sustainability disclosure in the Nordic countries
- German concerns over commercial confidentiality in financial reporting
- Ground breaking corporate governance developments in South Africa
- Innovation in Japan's corporate sector
- Tapping into the wealth of knowledge, skills and experience of institutions such as the World Bank

These instances, and many more like them, will all need intensive study and research to draw out best integrated reporting practise. Here at LSBF we would be keen to help with those research programmes of work.

Q.2 Do you agree with the above definition of Integrated Reporting? Why/why not?

Yes. However, we would make two points here.

Firstly the IIRC project needs to be clearly differentiated from other directions and innovations in corporate reporting, such as, for example, the balanced score card (BSC) so beloved of a certain generation of business schools. The BSC was always based on a reaction to a caricature of what accountants actually do. Whatever is said of accountants, and indeed what many accountants say of themselves, financial reporting ***does*** make presumptions about the future in a range of ways and through various calculative techniques, from discount rates through to useful economic lives and taking in estimates and provisions along the way. The leadership of IIRC knows and understands this very well.

Secondly, we would encourage the IIRC to be breath-taking and radical in its approach to the integration of reporting. If, as we believe, integrated reporting forms the strategic narrative of the corporation, then might there be a case for appointing a 'writer in residence' who would develop a novel, or perhaps short stories of the organisation? Or might it be innovative to bring a social anthropologist into the board room and the workplace to produce an ethnography of how we do business around here? We would support the IIRC in such initiatives – any less will be doomed

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to minor improvements of a practice currently mired in silos of specialisation and boiler-plating of disclosure.

Q.3 Do you support the development of an International Integrated Reporting Framework? Why/ why not?

Yes. We wholeheartedly support the development of an International Integrated Reporting Framework. Drawing on the author of this response's experience in the context of developing a Climate Change Reporting Framework under the auspices of the Climate Disclosure Standards Board, it will be vital to be inclusive and active in the engagement of relevant stakeholders. The CCRF has been consciously developed in the style of the International Accounting Standards Board, relying wherever possible and applicable on the IASB conceptual framework and vocabulary. At the same time the multidisciplinary nature of such a project means ensuring international inclusion, as well as specialists in measurement and uncertainty, and the corporate reporting community. Unfortunately, and for several reasons, persistent criticisms are levelled at the IASB's own consultation processes, and one only has to look at the controversy generated in the implementation of, say, IAS 19 among corporate reporters to realise that there can never be too much consultation in these situations.

Above all, the IIRC project must not be seen as another plaything of the big 4 accounting firms or the professional accounting bodies. Its ambition should be far beyond those narrow confines.

Q4. (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?

We agree that the initial focus of IR should be on reporting by larger companies and on the needs of their investors because these institutions have a duty to the public interest. In particular corporations enjoy the social contract of limitation of liability – a truly generous arrangement. However, it will be important for the IIRC to speedily settle on a robust working definition of what a 'larger' company means. This will need to take account of differing listing requirements in different jurisdictions. It will need to be mindful too of the fact that there are large private corporations.

It goes without saying that the practice of reporting in large, complex organisations will benefit from process mapping the who, what, why, when and how of this specialised mode of communication.

'Investors' too is a very broad category. It may cover everyone from the micro second trader to the long term pension fund manager. We would recommend that the IIRC consider carefully the segmentation and intermediarisation of the industry, and target their focus accordingly.

On both mapping and segmentation, LSBF would be pleased to progress research initiatives with the IIRC.

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(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?

Only in the broadest of terms, and only when it is clear that benefits outweigh costs for these categories. The assumption of 'trickle down' from the top table of corporate reporting is dangerous and naïve. IIRC will be well aware of the regulatory principle of 'thinking small first' and the limited success that this driver has had around the world. Small and medium sized enterprises are often the sources of innovation and agility, particularly in the area of communication and building brand and reputation and presence. It is perfectly plausible that concepts underlying IR may be tested by these other sectors, and found wanting.

Q.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?

We are unsure as to why (a) and (b) are separate categories. Surely the ability to create and sustain value over the short, medium and long term is a subset of an organisation's business model? In our view the business model is the central theme for the future direction of reporting. It is central because it is all encompassing and for the most part poorly understood – see our comments above on the work of the FRC.

It will be an achievement to get settled definitions of 'short, medium and long term'! Accountants and time are uneasy bed fellows, and too much that goes for corporate reporting of the future is based on naïve notions of discounting and 'risk free' discount rates. The on-going global economic rebalancing, the drying up of oceans of liquidity in the banking system, and the gathering storm of disruptive climate change mean that striving to reach that settled definition is a noble aspiration. Again LSBF would be pleased to offer its resources in developing lines of research that will help achieve that goal.

Q6. Do you find the concept of multiple capitals helpful in explaining how an organization creates and sustains value? Why/why not?

The challenge with 'multiple capitals' is its association with economic thinking and the danger of falling back into framing corporate reporting in terms of an economic conceptual framework. As the IIRC paper rightly shows, the most striking aspect of corporate balance sheets over the last few decades has been the growth of intangible assets. In economic theory this is described as 'total factor productivity' but is in fact a residual category, i.e. how to explain economic growth when all other factors have been taken into account. As long as 'multiple capitals' is used in this weaker, residual sense then it is of (limited) help in explaining how organisations create and sustain value. The central thrust of the IIRC project must be to encourage and respect multidisciplinary approaches to corporate reporting.

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Q7. 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?

Overall the guiding principles are well stated. The challenge will be in addressing the issues around commercial confidentiality. For example, how willing are corporations to freely disclose '…significant new opportunities, risks and dependencies that flow from the organisation's market position, strategies and business model?' This will be where effective stakeholder engagement with investors and reporters will be of the essence. It will be the *pull* of information flow from investors rather than the *push* of information flow from corporate reporters that will ultimately improve and lead to, integrated reporting.

The reference to 'future orientation' and to sensitivity analysis are points that are well made. If the IIRC are not already aware, the work of the 'Long Finance' forum is likely to be of relevance and value. In particularly, working with ACCA, they have developed a worked example of confidence accounting, which makes explicit the benefit of moving to using distributions rather than discrete values in auditing and accounting, particularly in the case of the banking sector. We would be happy to forward the worked example if required.

Q8. 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?

Yes, they do provide a sound foundation. In terms of governance and remuneration it will be important for the IIRC to keep an open mind on the diversity of regulatory regimes around the world and avoid falling back on the UK Combined Code with its imperfections and unintended consequences. In this context the phrase 'tone at the top' is helpful.

In terms of other Content Elements we consider that there should be a separate item covering supply chain identification and management, particularly in the context of a carbon constrained future.

And particularly in the light of an on-going worldwide banking crisis we would ask whether an additional Content Element on organisational risk appetite may be required?

Q9. From your perspective as a reporting organization:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

Benefits will need robust definition, particularly for corporate reporters who will have a fairly well defined sense of the cost of their finance function and statutory accounting, but a vaguer sense of the strands that come together in the production of the strategic narrative that is at the heart of corporate reporting.

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(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?

It is true that integrated reporting will move at different speeds in different jurisdictions, however it is an undeniable fact, alluded to above, that many regulatory initiatives have historically tended to flow from London and the London Stock Exchange and that this is unlikely to change for the foreseeable future.

'Safe harbours' are an excellent idea, but the allocation of liabilities up and down the reporting chain is a topic long overdue for radical overhaul. A clear need is flagged with fair and proportionate limitation of liability for the external auditor, but also the evolving rights and responsibilities of directors need to be addressed, particularly in the context of 'key man' insurance.

Commercial confidentiality will be a major hurdle to clear if integrated reporting is to be at all meaningful.

Q9. From your perspective as an investor:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

The events of the last three years have forcibly brought home the extent to which individual households are now (often unwillingly) investors. In some jurisdictions we own substantial parts of the banking system. The drive towards defined contribution post retirement provision forces us to confront the highly mediated investment sector. Integrated reporting must be viewed as a beneficial innovation into this changing landscape in terms of engaging with short termism in the investor value chain.

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?

We agree that short termism is a major challenge with increasing evidence of dark pools of liquidity, as well as micro second trading on the increase. Additionally the principal-agent problem seems more, not less exacerbated in recent years. And the integrated reporting initiative comes just at the same time as regulatory attempts in several jurisdictions to make the fee structure of investing more transparent. There will be many sensitivities requiring strong leadership and clarity of purpose from the IIRC secretariat.

(c) Do you agree that Integrated Reporting will drive the disclosure of information that is useful for integrated analysis? Why/why not?

Yes we agree. Sociological analyses show that investment analysts are respected not particularly for their share advice (buy-sell-hold) and are seen as rather lemming like in such advice. However they are more valued for the on-going narratives they develop about corporations,

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which provide a source of comfort to the wider investor community. Integrated reporting can only lead to better, more resilient and sustainable corporate narrative practice.

Q9. From your perspective as a policy-maker, regulator or standard-setter:

(a) Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?

We believe an added benefit of the IIR project will be the drive towards minimisation of unintended consequences arising as a result of poor regulatory design. The more complete the jigsaw, the less likely to find clusters of pieces in the wrong part of the picture.

(b) Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?

As noted above one of the key concerns will be around commercial confidentiality of corporate reporters. This may only be dealt with by building up a strong relationship of trust between stakeholders and the IIRC project.

Q9. From your perspective as a key stakeholder:

(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?

Q10. (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?
Q11. Do you have any other comments that you would like the IIRC to consider?

1. It will be vital to adopt a project focused approach to the IIRC work plan since funding will be driven by results
2. It will be vital to forge strong links with the technology sector to exploit much more effectively the leaps forward in that sector. The idea of 'safe harbours' and 'ideas labs' are good
3. IIRC will need to avoid 'capture' by vested interests, as well as not conforming to stereotype, e.g. 'this is just another initiative of the accounting big 4…' It has the potential to be much more
4. However, expectations will need to be carefully managed. Much of the IIRC project will be around exploring and dispelling uncertainty. As the world slips dangerously close to economic recession, stakeholders in the business of strategic narration need to understand that no 'silver bullet' will deliver integrated reporting
5. LSBF reaffirms its commitment to this important initiative and is keen to help where this is mutually of benefit.

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Best regards,

Dr. Steve Priddy, Head of Research