



APPENDIX 1 – Responses to the questions in the Discussion Paper *Towards Integrated Reporting – Communicating Value in the 21st Century*

THE WORLD HAS CHANGED – REPORTING MUST TOO

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

Yes. The way companies operate, transact business and benefit stakeholders continues to evolve. Financial information has remained the bedrock of information used by investors in making capital allocation decisions; however, information that is relevant to those decisions goes beyond financial information. Presenting a broader set of non-financial/operational and contextual information can provide investors with confidence in the quality and sustainability of a company's performance, its ability to create and sustain value and its ability to meet the non-financial expectations of a broad stakeholder group.

Attempts have been made to meet some of the increasing information needs of investors through additional requirements from regulators, standard setters and government. However, these have been undertaken in a way that has resulted in the information being isolated from the mainstream financial information. For example, our annual review of narrative reporting practices of the FTSE 350 showed a general trend of improvement in the quality and effectiveness of reporting; but we noted that the way in which companies report their business model in the UK – that is, how they create and sustain value – is mixed. Encouragingly, 33% of companies adopted early a legal requirement to provide this information. Yet the approach taken and quality of information reported varied significantly: much of the information was not comparable, and much of the disclosure was disconnected from information provided about corporate strategy, risks and performance (including the financial statements). This suggests the need for a clearer framework for companies to present how they create and sustain value.

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

Yes. The global nature of business models and the piecemeal approach to the development of regulations globally and geographically suggests the need for an international response to improve the corporate reporting model and to ensure it is fit for an interconnected world.

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TOWARDS INTEGRATED REPORTING

Q2. Do you agree with the definition of Integrated Reporting? Why/why not?

Yes. We also welcome the important distinction made in the paper between integrated reporting, integrated thinking and the ultimate output, an integrated report.

However, with the discussion of principles, content elements and exposure drafts, the paper seems to confuse the distinctions between these terms; it is sometimes unclear whether the paper is referring to a tangible output/report even when it is using the term 'integrated reporting'. We believe that most companies would need to apply an integrated approach in thinking about different information sets, market issues, business strategy, risk assessment, governance etc; they would also need a robust process for collecting, analysing and using this information to report a more integrated model. Each company can determine how best to communicate the information using the framework to be established and the integrated components of reporting. This should not be restricted to just the one report, referred to in the discussion paper, but should apply to other reporting by the company on whatever it is disclosing.

It is this integrated thinking that is fundamental to the implementation of integrated reporting. This is because many companies believe they have already produced integrated reports, by merging their sustainability reports with their annual mainstream filings and believe that this is the goal. Others believe the goal to be the alignment of strategy, risk, business model and key performance indicators and related reporting; yet others believe it to be the integration of their entity's activities throughout their entire value chain. But most of these companies have simply included this information rather than actually integrating it. So we would welcome the further clarity that will come from the pilot programme of the definition of these three terms.

We also recommend a strengthening of the current definition to convey the idea of reporting beyond the traditional boundaries under current financial reporting. This is critical to understanding how a company will generate value in the future; it should be an integral part of integrated reporting and explored as part of the pilot programme.

Additionally, as we have noted elsewhere in our response, there are terms used in the discussion paper that will need further clarification following this consultation, such as 'materiality', 'value' and 'stewardship'.

We also believe that the importance of the financial reporting model within the integrated reporting framework needs greater emphasis.



AN INTERNATIONAL INTEGRATED REPORTING FRAMEWORK

Q3. Do you support the development of an International Integrated Reporting Framework? Why/why not?

Yes. We support seeking ways to improve the corporate reporting model and its ability to help companies demonstrate how they create and sustain value for stakeholders. We are open to the idea that the integrated reporting framework under consideration is one of those ways. However, as we noted in our covering letter, we believe much still needs to be done. This includes fleshing out and adding clarity to various aspects of the framework.

Obtaining the buy-in of key constituencies, particularly regulators, is critical. And ensuring that the new model will replace, rather than add to, current requirements should be a key goal. Given that reporting requirements tend to evolve differently in different jurisdictions, an international reporting framework should promote consistency and comparability, to the extent possible, in how companies report their value creation processes. We recognise that practices will evolve at an industry or country level, depending on different business models/external drivers and culture. We believe that should occur within the constraints of a developed and internationally acceptable reporting framework.

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?

Yes. Large companies usually have a broad group of stakeholders and investors and are therefore often more adept at meeting their information needs. A framework that is successful in meeting those needs using a principles-based approach should be adaptable for smaller companies as well. Larger companies have also traditionally led corporate reporting initiatives, and often the resources and skills necessary to achieve effective reporting are more available to them than other companies.

We also agree that the primary focus of the discussion paper should be the needs of investors. We believe that a project aimed at addressing the needs of all stakeholders at once would be impractical, and that providing relevant information for investors on the basis proposed would also provide information relevant to other stakeholder groups. One of the key characteristics of the framework should therefore be to promote consistency and comparability in satisfying investor needs. Adding the interests of any other stakeholders later in the project is likely to make it more onerous, so the benefits would have to be clearly demonstrable. A filter might be required to determine which requirements are most relevant, otherwise the process would be in danger of becoming a 'free for all' for any special interest group and losing its focus.

(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?

Yes. We believe in the establishment of a principles-based framework, so we are of the view that the principles and concepts embodied in an integrated reporting framework should apply equally to small, private or not-for-profit organisations as they would to larger organisations. However, there is a real danger of overburdening smaller organisations; we therefore believe that the application of the integrated reporting framework needs to be proportionate to these organisations' scale and audience.



In order to ensure that the reporting needs of these entities are appropriately considered, we encourage the IIRC to broaden the scope of entities participating in the pilot programme to include these types of entity. This will also be useful in ensuring that the framework does not result in an excessive economic burden in the longer term.

Q5. 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?

Yes. The company’s business model and its ability to create and sustain value in the short, medium and long term are crucial themes for the future direction of reporting.

However, there needs to be greater clarity about what is meant by a company’s business model and its ability to create and sustain value and, as noted in our response to Q2, to what extent the definition should encompass a company’s impact or reliance on capital outside its accounting definition of control.

5a) Business model

On the face of it, reporting on a company’s business model seems straight forward; but, as noted in our response to Q1 and evidenced by our review of the narrative reporting practices in the FTSE 350, there is a great deal of uncertainty over what ‘business model’ means and how it should be reported.

Our research, published in October 2011, highlights the need for explicit guidance. ‘Business models’ have been defined in a variety of ways by early adopters of the UK governance code’s new requirement to disclose the business model. Companies that reported their business model appear to have focused on presenting information to comply with the requirement, rather than making the information’s relevance clear and linking it to other parts of the narrative.

While 75% of companies mentioned the term ‘business model’ in their annual reports, 18% gave little or no explanation of what it means, and only 24% made implicit references to the business model in the narrative. 33% of companies provided a clear definition of their business models, but there is little consistency among these companies on what the key elements of a business model are.

This disjointed picture is emphasised by limited linkage between the business model and other key elements of the business. Only 13% explicitly tied the business model to measurement; 7% linked their business models to risks; and only 14% made the connection with corporate social responsibility. Just 7% of companies explained the role of the corporate centre in delivering on the business model.

To be of benefit to preparers and users, a company’s business model needs to be clearly integrated with the key aspects of strategy, risk, governance and performance. Experience suggests that focusing on the business model will require significant input and debate from management and the board but that this internal debate and challenge is a necessary and healthy one.

5b) Value creation

As noted in our covering letter, we believe there is a certain ambiguity over the phrase ‘create and sustain value’. It means different things to different stakeholders, and indeed investors depending on whether they are short or longer term. The definition will therefore differ when you consider a



company's activities and whether you take into account activities outside the traditional accounting definition of control. We therefore encourage clearer guidance on what is meant by 'value creation' and an explanation of the linkage to the different forms of capitals in a simpler and more direct way. In this context, the use of the term 'materiality' in the paper is potentially confusing, given its existing use within financial reporting. The term 'relevance' would be better, together with a clearer definition of what is meant by it and how it will be determined – by the preparer, investor, auditor and regulators. This will help in determining what is meant by 'value creation'.

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

Yes. As a natural extension of the business model and consistent with our capital markets research, we believe the concept is useful. We believe the importance of reporting the economic impact of constraints on different forms of capital on how companies create value will be increasingly important. However, some of the 'capitals' – for example, financial capital – will be more easily categorised, defined and measured than others such as social capital. We hope that the pilot programme will produce practical insights into how companies are interpreting each capital, the importance they ascribe to each in their value creation processes, how each capital is captured and measured, and whether companies believe there are other capitals on which their performance depends.

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?

Yes. We believe a framework, driven by clear principles, is critical for an area of reporting where what is communicated needs to be driven by management's perspective on what is important and then corroborated by key external stakeholders. We therefore strongly support the development of principles as set out in the discussion paper. Indeed, PwC's 'integrated reporting framework' – the codification of over a decade of research into the information needs of the capital markets – is entirely consistent with the guiding principles and content elements. However, we do believe greater clarification may be needed around some of the guiding principles and further additions, as follows:

i. Greater clarification

As noted in our response to Q5, we believe it would be helpful to use the term 'relevance' rather than 'materiality' and to include a clearer definition of what is meant by it. This would ensure a common understanding and a common methodology for determining what is and isn't material.

ii. Additional principles

We suggest adding a separate guiding principle called 'balance', which addresses a greater need for openness and transparency. Such a principle would emphasise the importance of companies not only telling their success stories but also explaining where and why goals have not been achieved. Companies should balance the description of negative and positive developments.



Further, we believe the principle of comparability needs more consideration. This is referred to within the paper but not explicitly within the principles. By using a company's business model as the foundation for a reporting framework, there is clearly a recognition that this will ultimately lead to subtle differences between companies' disclosures. However, investors increasingly want greater comparability in these broader areas of reporting if the information is to prove useful. We therefore encourage greater recognition of the importance of comparability. We note that this is likely to be driven down industry lines or by particular data points – for example, carbon emissions. It will be interesting to note whether comparability happens naturally over time among companies participating in the pilot programme.



CONTENT ELEMENTS

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. As noted in our response to Q7, the content elements are broadly consistent with our integrated reporting model. However, we note that our framework sits over the top of the financial reporting model and provides users and preparers with the information to understand, and have confidence in, the quality and sustainability of performance.

We therefore think that the interplay between these content elements and the information in the financial reporting model needs to be considered. We recognise that the financial reporting model has its limitations, but the more the content elements can be grounded in financial information and a clear link between the two is provided, the more tangible the information will be, and the more relevant it will be for primary users – the investment community. Businesses, at least in the ‘profit’ sector, ultimately exist in order to generate cash flows, and integrated reporting must be grounded in this context. Financial reporting should be a key part of integrated reporting.

Finally, we do not think that future outlook should be included as a content element but as a principle that applies to all the content elements.



WHAT WILL INTEGRATED REPORTING MEAN FOR ME?

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?

Yes. Our research into the information needs of users as well as our ongoing engagement with companies worldwide on the reporting agenda suggests that many of the potential benefits highlighted in the discussion paper for companies and investors could be achieved in varying degrees.

However, from all of our engagements with preparers and users, one benefit that is referred to, but we believe shouldn't be underestimated, is the behavioural change that the internal debate and challenge required to implement an integrated reporting framework is likely to engender. There is no doubt that integrated thinking will help drive more effective integrated reporting within a company and externally to investors and other key stakeholders. But the process of holding up a mirror to existing external reporting and management information in the pursuit of providing a more integrated picture of strategy, governance, actions and performance can often act as a catalyst for change within a company.

Some of the perceived benefits described in the paper appear to be 'anecdotal'. For example, it is unclear whether integrated reporting will contribute to 'lower volatility in markets', as suggested on page 23. We agree with the benefit of harmonisation from the regulators' perspective, but it should be recognised that this is a longer-term ambition and will require regulators and standard-setters, globally and in various territories, to work together to eradicate duplication, immateriality and red tape.

We recommend the pilot programme to be conducted in a way that can help to confirm as many of the stated benefits in the discussion paper as possible. In our view, demonstrating the benefits of integrated reporting, or any new reporting model, is critical to gaining buy-in from relevant constituent groups. Where the results of the pilot programme suggest that a benefit is not attainable or observable, we recommend discontinuing references to it. This will help to move the discussion from high-level concepts and aspirations to something that appears to be more grounded, achievable and operational.

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

Yes. Overall we agree with the main challenges identified in the paper; however, we believe some need greater emphasis than others.

A major challenge for companies will be to amend their existing reporting processes/data sets in order to be able to generate non-financial information at the same time as financial information, for it to be of similar quality, and to understand the interaction between operational and financial data. The paper identifies the concept of integrated thinking, but the challenge of implementing this should not be underestimated. We therefore think this should be emphasised, as many preparers we have spoken to feel integrated reporting is relatively straightforward to implement until they begin to better understand the concept.



The provision of independent assurance on integrated reports and the nature of information disclosed will require new auditing techniques. It is clear from the area of corporate social responsibility that when information is considered important, assurance providers need to be able to adapt to give preparers and users the comfort they need about the reliability of the information. If the objective is to publish an integrated report that provides a snapshot of the company's most strategic/material information, there need to be certain mechanisms in place to determine the robustness and reliability of the disclosures made. Therefore, in considering the reporting model, there needs to be a consideration of how the audit will be adapted to consider issues involving governance, the business model and risk, which are as important to a company's long-term sustainability as its financial performance. How these matters should be reported on, in the integrated report or in a separate report also should be considered. This will require more analysis of what preparers and users need so that a model is not imposed on them that is inefficient, costly and irrelevant. We remain committed to playing a role in this development in order for the assurance model to remain fit for purpose.

We agree that integrated reporting could provide the basis for harmonising the regulation of reporting, but there needs to be recognition that this is a longer-term ambition and will require regulators and standard-setters globally and in various countries to work together to eradicate duplication, immateriality and red tape.

It is important the framework doesn't try to be all things to all people. This will only lead to frustration on the part of some, who will form expectations based on the discussion paper and subsequent documents but feel that the model did not meet their expectations. Others may puzzle over the output of the model and struggle to see how it achieves the many benefits described in the paper. As we noted in our covering letter, in moving forward there needs to be clear prioritisation with a focus first on investors. In this way, the many challenges raised by the proposed framework can be narrowed to those relating to this most important group and, once resolved, set the stage for other challenges to be addressed with the benefit of experience and hindsight.

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

Yes. But there will need to be sufficient benefits (perhaps a lower cost of capital) if companies are to have an appetite to change behaviour. If this occurs, we can envision integrated reporting driving disclosure of such information. We recommend that the IIRC considers whether academic research, conducted as part of the pilot programme, be used as a basis for helping to determine whether there is evidence for such benefits.



FUTURE DIRECTION

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?

We recommend not proceeding to an exposure draft of the framework in 2012 as planned. Much still needs to be done – as discussed in our response to question 3 and in our covering letter – before reaching a stage where a clear, operational framework can be exposed for comment. This includes understanding the results of the pilot programme, which is scheduled to run for two years ending in October 2013, as well as other innovation in the markets. We see the role of the IIRC and the paper as challenging the status quo, presenting a vision and making a case for change; those responsible for the system need to consider how this type of model can evolve in a structured, valuable and logical way.

The paper acknowledges that a discussion with policymakers, regulators and standard-setters is anticipated. As we've noted elsewhere in our response, it is important to work with key regulators, policymakers and others to agree on a model that will replace rather than add to the existing reporting model. This should be done before an exposure draft is issued. Without such an agreement, we believe preparers' willingness to voluntarily adopt an incremental model, which would impose added cost and burden to an already challenging financial reporting model, would be significantly diminished. Further, given the vision that the proposed model would be more transparent about a company's business model and its value creation process, companies in some jurisdictions will be concerned about increased legal liability. The IIRC should consider engaging policymakers and lawmakers to find appropriate solutions to this concern or identify adjustments to the proposals to accommodate it.

While the paper acknowledges consultation as an important future action, we recommend that this include educating various parties, rather than just raising awareness, about the proposed model. Given the significant change the proposed model represents, educating relevant parties about its benefits, how it would operate and what needs to be in place for the model to be sustainable in the long-term is important to achieving the buy-in of key stakeholder groups.

(b) What priority should be afforded to each action? Why?

Ultimately the integrated reporting framework needs to be maintained by a body equivalent to a standard-setter, with proper governance and a representative geographical balance. The IIRC may play this role, but we do not advocate them moving too quickly away from the critical role that they are currently playing of creating awareness, promoting best practice and maintaining the momentum behind such an important topic.

Other key priorities should be the completion of the pilot programme and evaluation of its results, and reaching an agreement with regulators and others that would enable the new reporting model to replace, rather add to, the existing reporting model.



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

The examples in the discussion paper of ‘current innovation’ are excerpts from various reports and do little to paint a picture of what an integrated report would look like. Providing meaningful examples that highlight the mechanics of preparing such a report would go a long way to improving the clarity of the proposals, taking it from high-level concepts to something that could be understood in practice. We encourage the IIRC to provide a fuller picture of how integrated reporting would work in practice. Creating a clear path between the current reporting model and the vision would help to engage and achieve buy-in with critical stakeholder groups.

There is a presumption based on the current model that annual reporting remains the appropriate standard for the frequency of reporting. This may well still be appropriate, but the Integrated Reporting project should consider whether any information should be reported more (or less) frequently.

Current law and practice surrounding the production of the annual report is based on the report being a written document in either print or pdf form. Developments in technology mean that new types of report are starting to appear on other platforms – for example, for tablet computers – and have a very different look and feel. As the world becomes more connected and technology is used to achieve greater influence with various groups, the IIRC should be sure it has considered how the proposed reporting model would operate in an increasingly digital age. Further, the IIRC should consider how young people, who are often more adept at using different technology and may be more likely to look at innovation through a high-tech lens, see the proposed model.

The IIRC also should consider what role the leadership of a company should have in the proposed framework. This may be an opportunity for the IIRC to promote certain positive behaviours through the framework, encouraging companies to provide greater transparency into their businesses and potentially increasing the degree of trust that a company’s stakeholders have in the leadership of the company and the company itself.