



24 Cathedral Road / Heol y Gadeirlan  
Cardiff / Caerdydd  
CF11 9LJ  
Tel / Ffôn: 029 20 320500  
Fax / Ffacs: 029 20 320600  
Email / Epost: [wales@wao.gov.uk](mailto:wales@wao.gov.uk)  
[www.wao.gov.uk](http://www.wao.gov.uk)

**[dpresponses@theiirc.org](mailto:dpresponses@theiirc.org)**

Date 12 December 2011  
Our ref 1212.mju.iirc.resp  
Pages 1 of

Dear Sir or Madam

### **Integrated Reporting**

The Auditor General for Wales welcomes the opportunity to comment on these proposals for the development of Integrated Reporting (IR). This response has been prepared on behalf of the Auditor General by the Wales Audit Office.

In preparing this response on behalf of the Auditor General, we have focused on the implications for the entities that fall within his remit, namely:

- The National Assembly for Wales;
- The Welsh Government and its related bodies;
- Welsh Government Sponsored Bodies;
- Local Authorities in Wales (including related charities);
- Local Health Bodies in Wales (including related charities);
- Higher Education/Further Education institutions in Wales; and
- Public sector pension schemes in Wales.

We welcome this initiative towards integrated reporting and agree with the aspirations contained in the discussion paper. It is difficult to disagree with the matters raised in this paper. However the concepts are set out at an extremely high level and there is inadequate recognition of the many difficult practical issues to be resolved in implementing the proposals, for example:

- in the area of resources/capitals there is inadequate recognition of the extreme complexity of these issues. Academic research on social capital for instance has not yet produced a workable model in the context of individual entity (see response to question 6);
- there are issues to resolve regarding the extent to which intellectual capital that is embodied in individual employees is controlled by the entity. Consequently, there are significant measurability and recognition issues arising in respect of IR (see response to question 6);

- it will be very difficult for auditors to obtain sufficient assurance over much of the content of the IR. For IR to be credible, there will be a need to develop audit procedures and reporting arrangements (see response to question 9).

We also have reservations regarding:

- a lack of recognition of the public sector. A failure to address this issue at this early stage could undermine the extension of IR into the public sector (see response to questions 1(a), 2, 4(a) and 4(b));
- a lack of recognition of the experience of the public sector in developing aspects of IR to date (See response to questions 1(a), 4(a) and 9(b).

Our detailed responses to the consultation questions are contained in the attached appendix.

I hope that you find these comments useful. Should you have any queries regarding this letter, please contact my colleague Iolo Llewelyn by telephone (07766 505189) or e-mail ([iolo.llewelyn@wao.gov.uk](mailto:iolo.llewelyn@wao.gov.uk)).

Yours faithfully,



**Mike Usher**

**Group Director – Technical**

## Appendix: responses to consultation questions

### The World has Changed – Reporting Must Too (page 5 of the Discussion Paper)

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

We agree that changes in business models, developments in the concepts of governance and accountability and increasing demands from stakeholders for information on entities' activities are challenging current models of reporting by both private and public sector entities.

However we do not consider that the analysis of the information provided in the exhibit headed 'Components of S and P 500 market value' (page 4) is robust, and does not in itself necessarily support the development of a new paradigm of corporate reporting:

- the reduction in the proportion of market value represented by physical and financial assets could simply be due to reductions in stock market yields in general or of changes over time in the requirements of accounting standards regarding the capitalisation and/or valuation of assets;
- whilst business models have changed significantly over recent years (e.g. expansion of service industries, outsourcing of manufacturing) resulting in a reduction of the more asset based manufacturing businesses of yesteryear, this trend does not necessarily evidence the need for IR;

A more robust analysis of the changes in business behaviour is required to support the case for IR.

In addition this discussion paper ignores the public sector perspective. The public sector has, to a large extent, recognised the limitation of the traditional model of reporting and many countries have developed performance reporting guidance. The draft International Public Sector Accountancy Board (IPSASB) conceptual framework states:

*'The scope of financial reporting should be sufficiently broad to allow General Purpose Financial Reports (GPFRs) of an entity to report financial and non-financial information about the past, present, and the future, including prospective financial and other information about future service delivery activities and objectives, and the resources needed to support them.'*

#### Q1. (b) Do you agree that this action should be international in scope? Why/why not?

Yes. We note that the requirement for non financial reporting, which is still largely based on the requirements of domestic legislation, varies between countries far more than does financial reporting. IFRS is now the de-facto global financial reporting standard. However it has taken a very long time for IFRS to achieve this pre-eminent position (the first IAS

was issued in 1973) and the issues that had to be addressed in developing IFRS were arguably far better developed than many of those that need to be addressed by IR.

### **Towards Integrated Reporting (page 6 of the Discussion Paper)**

#### **Q2. Do you agree with the definition of Integrated Reporting on page 6? Why/why not?**

We agree with the definition for private sector entities.

However it is unclear whether this can be applied as written to the public sector. The IPSASB considers that the main objective of public sector entities is to deliver goods and services rather than to generate profits. These goods and services (which include establishing and maintaining a framework of laws and other relevant social arrangements) are those that:

- enhance or maintain the well being of citizens; and
- tend to be provided in a non competitive environment because they cannot be provided as well, or at all, by the private sector.

The role of the budget, the more widespread use of non-exchange transactions and the regulatory role of government are also areas where the public sector differs substantially from the private sector.

The public sector evidently creates value, such as a better educated, healthier population, better transport links, a framework of laws etc, but these outputs and outcomes are not normally expressed in the context of the term 'value'.

We consider there is a need to assess whether this definition is appropriate for the public sector.

### **An International Integrated Reporting Framework (page 8 of the Discussion Paper)**

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

Yes - such an approach replicates that which has been adopted successfully for financial reporting.

#### **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?**

Larger private sector companies that are subject to a higher level of external scrutiny have the resources to lead initiatives such as this (which replicates the process usually taken for the introduction of IFRS e.g. in the UK) and are influential on the practices of smaller entities.

However, we consider that this initial focus should also include the public sector for the following reasons:

- it consists of a large proportion of the economy;
- the development of the role of the public sector in society plays well with the IR approach; and
- the public sector has a long history of reporting non financial performance.

As noted previously, the objectives of public sector entities differ from those in the private sector. Consequently, there is a need to consider at an early stage whether the different characteristics of the public sector require a different IR framework.

There will also be a need to consider the primary users of IR in the context of public sector entities. IPSASB in its draft conceptual identified the potential users of general purpose financial reports of public sector entities as:

- recipients of services or their representatives;
- providers of resources or their representatives; and
- other parties, including special interest groups and their representatives.

The legislature is a major user of GPFRs. It acts in the interest of members of the community, whether as recipients of services, providers of resources, or citizens with an interest in, or need for, particular services or activities.

**Q4. (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?**

We agree that the concepts underlying IR will be equally applicable to small and medium enterprises although the simpler the entity the less relevant it will be.

The different objectives of public sector and not-for-profit entities indicate that a modified/different integrated reporting framework may be needed for such entities.

**Business Model and Value Creation (page 11 of the Discussion Paper)**

**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? Why/why not?**

We agree that these themes are appropriate for private sector entities. However, from the public sector perspective this may only be appropriate if the term 'value' is replaced by 'service potential.'

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

Yes we find the concept useful but consider that there are significant practical issues to be addressed especially regarding the control and measurement (and consequently

recognition) aspects of many of these types of capital, in particular of human and social capital and aspects of intellectual capital, for example:

- academic research on social capital for instance has not yet produced a workable model in the context of the individual entity; and
- there are issues to resolve regarding the extent to which intellectual capital that is embodied in individual employees is controlled by the entity.

### **Guiding Principles (page 12 of the Discussion Paper)**

**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?**

We agree that the Guiding Principles identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report.

### **Content Elements (page 15 of the Discussion Paper)**

**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?**

We agree that the Content Elements identified in the Discussion Paper provide a sound foundation for preparing an Integrated Report.

### **What Will Integrated Reporting Mean for Me? (Reporting organizations – page 21, Investors – page 22, Policymakers, regulators and standard-setters – page 23, Other perspectives – page 24 of the Discussion Paper)**

**Q9. (a) From your perspective: Do you agree with the main benefits as presented in the Discussion Paper? Why/why not?**

We agree with the main benefits listed.

**Q9. (b) From your perspective: Do you agree with the main challenges as presented in the Discussion Paper? Why/why not?**

We agree with the main challenges listed. We also note the implementation challenges that we outline above in response to some of the previous questions.

The section headed 'other perspectives' recognises the critical role of independent audit in providing assurance regarding the accuracy of financial reporting. However, the performance information presented in pages 16 – 19 is not currently subject to audit, but rather, in accordance with ISA 720 (The auditor's responsibilities relating to other information in documents containing auditing financial statements) it is 'read' by the auditor in order to 'identify material inconsistencies, if any, with the financial statements'.

Providing assurance on many aspects of the information to be provided under IR will therefore require development of current audit practices. If IR is to be realised in practice this issue should be considered at an early stage.

The International Audit and Assurance Board has developed standards for 'Assurance Engagements Other Than Audits or Reviews of Historical Financial Information', (the ISAE series), and these may form the basis of an approach to audit non financial information published with financial statements.

Again the experience of the public sector may be relevant, as public sector audit agencies in many countries are required to audit a range of non financial performance information.

**Q9. (c) From your perspective: 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?**

We agree.

#### **Future Direction (page 25 of the Discussion Paper)**

**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 broadly agree with the proposed next steps in the development of the IR Framework. However we consider that the public sector perspective should be incorporated into the Exposure Draft of the Framework. In doing so, we consider that useful background information has already been developed by the IPSASB including:

- the IPSASB Public Sector Conceptual Framework Exposure Draft;
- IPSASB Exposure Draft 46 – Recommended Practice Guideline, Reporting on the Long Term Sustainability of a Public Sector Entity's Finances; and
- the IPSASB consultation paper Reporting Service Performance Information.

**Q10. (b) What priority should be afforded to each action? Why?**

We have no views on this matter.

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

In order to facilitate responses to the Exposure Draft of the IR Framework, it would be useful if such a document included paragraph numbers.