Comments on Draft IIRC Reporting Framework of April 11, 2011

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1. Integrated Reporting Model (§2.2 of Draft IIRC Framework)

1.1 Six Capitals Too Abstract. The discussion on value, the *six capitals* and business model is too long and abstract to be placed at the outset of the framework, and is more likely to intimidate and discourage potential users of the framework rather than entice them to read more and adopt the framework. The capitals discussion, while interesting and used elsewhere in the past (see, e.g. , the British Sustainability –Integrated Guidelines for Management) does not easily and intuitively translate into a vision of reporting that current reporters could readily embrace. The concept of the *six capitals* would be better placed before a working group charged with identifying common indicators that could measure the gain or reduction of such capitals on an annual basis. The presence of such indicators linked to each capital would thus provide a more intuitive understanding of the capitals concept. Without that, users of the framework would be left to puzzle about the practical meaning and application of the concept.

1.2 Emerging Meaning of Sustainability. A simpler and more intuitive lead-in for the framework would be to emphasize that from an organization's perspective, sustainability is coming to mean "values-driven management framed around social, economic and environmental responsibility for the purpose of establishing and *sustaining* the long-term well-being of society (including the environment) as well as the organization." The purpose of integrated reporting is to demonstrate how well the organization is embracing that management approach and the value it is bringing to the organization and "society" (i.e., to its key internal and external stakeholders).

1.3 Consensus Sustainability Topics. In light of the years of global multi-stakeholder engagement and debate by such institutions as the Global Reporting Initiative and the Working Group on the ISO 26000 Social Responsibility Guideline Standard, we now have a clearer understanding of the growing consensus as to the scope of social, economic and environmental responsibility expected of organizations by global stakeholder groups. See Figure 1.3.1, below, for example. In essence this scope entails the following:

1) **Governance:** oversight structures and systems for legal and ethical compliance and risk control (enterprise risk management) on below topics for organization and its supply chain

2) **Human Rights**: civil rights, nondiscrimination, etc.

3) **Labor Practices**: wages, working conditions, etc.

4) **Environmental Issues**: pollution, energy and resource conservation, biodiversity, etc.

5) **Fair Operating Practices**: anti-corruption, fair competition, responsible political involvement, etc.

6) **Consumer/customer Issues**: fair marketing, consumer safety, product compliance, products and services for the poor, etc.

7) **Community Involvement & Development**

8) **Economic Viability of the Organization:** sales, profit, loss, cash flow, retained earnings, etc.

Figure 1.3.1	
ISO 26000 Social Responsibility Core Subjects	**GRI Sustainability Indicator Categories/Aspects**
Organizational Governance	Governance
Human Rights	Human Rights
Labour Practices	Labor Practices & Decent Work
The Environment	Environment
Fair Operating Practices	Society: Corruption, Public Policy, Anti-competitive Behavior, etc.
Consumer Issues	Product Responsibility
Community Involvement & Development	Society: Community
	Economic: Economic Performance, Market Performance, etc.

1.4 Sustainability Commitment/Expectations Statement. One purpose of an integrated report is to show how the organization is meeting the social, economic and environmental expectations of its key stakeholders. To help the organization understand and communicate these expectations and align its internal efforts toward them, a short vision statement or policy of sustainability commitments/ expectations can be prepared. This is best done by engaging stakeholders to discuss their highest priority expectations of the organization on the eight sustainability topics noted above. One example of such a policy can be found in Appendix A, below. The IIRC Framework

should encourage reporting organizations to develop such a policy or vision statement and refer to it in the report.

1.5 Value of Sustainability Approach; Integrated Reporting as Part of Management Process. The business case for addressing sustainability (social, economic and environmental responsibility) in the organization is really the business case for a process that prioritizes among the opportunities and threats (see Figure 1.5.1, below) posed by various sustainability trends (see Figure 1.5.2, below) and issues (see Figure 1.3.1, above) to select those for action that contribute the most value to the organization and its key stakeholders. The ultimate value from such effort is manifest in the threats reduced and managed and in the opportunities realized. Integrated reporting is an important part of the cyclical management process of planning, executing, monitoring, reporting and re-planning that is used to help fulfill stakeholder expectations and achieve such value. Since the threats and opportunities noted in Figure 1.5.1 are commonly understood by business people, this discussion of value would be readily grasped by them and therefore should be incorporated in the framework text.

Figure 1.5.1
Common Organizational Threats and Opportunities

Threats	Opportunities
-Legal	-Productivity, cost
-Financial	-Employee relations
-Reputational	-Reputation, brand
-Competitive	-License to operate, community appeal
-Operational	-Sales, new markets, customer appeal
	-Innovation, new products and services

Figure 1.5.2
Three Dozen Common Sustainability Trends[1]

1. Growth in Global Business Competition
2. Opposition to Globalization
3. Speed of Communications; the Digital Divide
4. Widening Prosperity Gap
5. Population Growth; Mortality Rates
6. AIDS and Other Serious Diseases
7. Mental Health Problems
8. Increased Immigration, Lower Fertility in Industrialized Nations
9. Hunger and Malnutrition
10. Child and Forced Labor
11. Education Needs for the Disenfranchised
12. Urbanization
13. Over-consumption of Resources
14. Fossil Fuel Depletion
15. Climate Change
16. Deforestation
17. Threats to Biodiversity
18. Fresh Water Depletion; Water Contamination
19. Wetlands Destruction
20. Fish Depletion
21. Coral Reef Destruction
22. Spread of Hazardous Pollutants
23. Traditional Air Pollutants
24. Declining Soil Quality
25. Ozone Depletion
26. Low Credibility of Corporations
27. Extended Producer Responsibility
28. Green Products
29. Green Marketing/Labeling
30. Green Product Certification
31. Obesity; Food Nutrition
32. Rise in Socially Responsible Investing
33. Investor Concerns about Corporate Governance
34. Increased Demands for Transparency, Public Reporting
35. Growing Power of NGOs/CSOs
36. Increasing Global Terrorism

[1] For a summary of these trends, see William R. Blackburn, *The Sustainability Handbook—The Complete Management Guide to Achieving Social, Economic, and Environmental Responsibility,* Environmental Law Institute, 2007, Appendix 1.

2. Guiding Principles for Integrated Reporting (§2.3 of Draft IIRC Framework)

2.1 Consensus Reporting Principles; Connectivity. The principles of the framework that align with those identified in the GRI Guidelines and ISO 26000 (see Figure 2.1.1, below) are appropriate, given the support for them achieved through the GRI and ISO global multi-year multi-stakeholder forums. The "Connectivity of Information" is confusing and should be restated or replaced with a principle that refers to showing the connection between what is in the report and the commitments in the organization's sustainability vision or policy statement (see 1.4, above, and Appendix A, below).

Figure 2.1.1
GRI and ISO 26000 Reporting Principles

ISO 26000 SR Information Characteristics	GRI Reporting Principles (with Tests)
1. Complete	Completeness
2. Accurate	Accuracy
3. Balanced	Balance
4. Timely	Timeliness
5. Understandable	Clarity
6. Responsiveness	Stakeholder Inclusiveness
7. Accessible	
8.	Comparability
9.	Sustainability Context

2.2 Clarification of Responsiveness. The principle of "Responsiveness and Stakeholder Inclusiveness" is appropriate but should be clarified to also say that the report itself should address those issues that key stakeholders find most important as determined through some stakeholder engagement process.

2.3 Relevance vs Materiality. The text should clarify that relevance is about the *nexus* between and issue and the organization and its impacts, whereas materiality is about the *significance* of the impact or effect on the organization or by it as determined by the organization and its key stakeholders (not just investor/owners). Also, as a practical matter, most organizations that undertake a materiality evaluation first identify issues likely to be material (significant) and then confirm that significance for the final determination. It makes little sense to start with an impossibly long list of relevant issues that could have only some slight connection.

2.4 Transparency; Protection of Sensitive Information. Transparency needs to be emphasized under the neutrality/balance principle or, even better, in a principle of its own, since the lack of transparency is one of the biggest reasons reports—both financial

and sustainability—are currently of limited value to readers. And as Figure 2.4.1 notes, stakeholders find reports to be more credible if they are written in a transparent way. Certainly, strengthening the credibility of the report—and reporter-- should be a key objective of integrated reporting. For these reasons, the framework should specifically state that the report should cover significant failures, shortcomings, gaps in performance, threats and weaknesses that relate to material sustainability (including financial) issues. A Google search of controversies involving the company can provide a good clue as to publicly sensitive issues that should be covered.

The tension between transparency and the protection of sensitive commercial information should also be addressed in the framework guidance. In the early years of public environmental reporting it was often argued that waste and emissions data should not be disclosed because a competitor might be able to use that information to back-calculate sensitive production information. But as years went by, that concern has diminished substantially and waste information is commonly disclosed. As a general rule of thumb, where there is doubt, companies should error on the side of disclosure, especially about data of the type that is commonly disclosed by competitors or in some jurisdictions governmentally mandated for public disclosure. Following the so-called "Squirm Test," if there is nothing in the report that makes the organization's leaders uncomfortable ("squirm in their seats" a bit), then the report is probably not transparent enough.

The California case of *Kasky v. Nike* underscored the importance of having accurate, transparent information compiled in a single companywide report for reference by company spokespersons around the world. Having company spokespersons shoot from the hip in responding to public inquiries on important financial and sustainability issues is a recipe for a public relations disaster.

Figure 2.4.1
Improving the Credibility of Sustainability Reports
—Key Factors Identified in Two Surveys

- Be humble, not self-serving
- Be honest about mistakes and bad practices
- Address the difficult, controversial issues
- Externally verify the report
- Use an external reporting standard (e.g., GRI)

Sources:	-Pleon Kohtes Klewes Survey of Global Stakeholders (2005) -Edelman Survey of Pharma Stakeholders (2006)

2.5 Comparability. Comparability should enable comparison from one organization to another, but should also enable comparison from year to year, especially for the last three years and, in the case of metric goals, the base year. Where metric goals are used, comparability may require the adjustment of baselines to account for significant business acquisitions or divestitures.

2.6 Verification/ Assurance. Verification should not be covered as a hard principle but simply encouraged and covered in more flexible guidance within the Framework. The guidance should address the difficult issue of cost, the need for multi-functional auditing teams, and how a verification process may be phased in over time in a cost-effective way using internal and external resources. The guidance should distinguish the verification of performance and the selection of material issues, which is often undertaken by a panel of representative stakeholders, versus the verification of data accuracy and reliability, which is most often confirmed by auditors.

3. Content Elements of an Integrated Report (§2.4 of Draft IIRC Framework)

3.1 Report Profile. The Profile should also explain what organizational and geographic part of the organization and its value chain is being covered by the report, and for what period. (The framework should mention the GRI boundary setting guidelines and other guidance that may be helpful in deciding what entities and activities beyond its corporate boundaries should be covered by the report.) If only parts of report have been verified by external parties, that should also be explained. The Profile, or perhaps the Organizational Overview discussed below, should also mention important guidelines or standards, such as the IIRC framework, the GRI Sustainability Reporting Guidelines, the UN Global Compact and the OECD Guidelines for Multinational Enterprises, that the organization endorses and uses, and explain if and how performance against those commitments is captured in the report or elsewhere.

3.2 Organizational Overview. The Overview should also reprint any short statement of values or sustainability vision (see e.g. ,section 1.4, above, and Appendix A, below) that guides the organization on the major sustainability issues identified under section 1.3, above. The linkage between this statement and the content of the report should also be explained.

3.3 Strategic Objectives. This section should also show how the objectives are linked to the statement of values/sustainability statement mentioned in 3.2, above, and how various goals, KPIs and other important indicators are linked to the objectives. The process of prioritizing objectives and setting goals with help from stakeholder engagement should be explained.

3.4 Governance. The Governance section should also explain which board subcommittee is specifically accountable for assuring the appropriate resources and processes are in place to provide a timely, good quality integrated report, and that such reporting process is linked with the company's enterprise risk management process. See, for example, the South African King III governance standard, which assigns responsibility for this to the board's audit committee. The text should also talk about how strategic objectives are deployed throughout the organization and what training, monitoring, and accountability mechanisms exist to assure good execution.

3.5 Performance. Performance over the last three years, plus baseline performance for each metric goal, should be provided in the report. The text for Performance should specifically mention that gaps in performance, shortcomings and other failings, and in particular public controversies easily found via Google, should be explained in a balanced way to meet stakeholder expectations about transparency. Critical stakeholder statements should be quoted if relevant and representative. The use of graphs and tables should be encouraged.

3.6 Connectivity. The Connectivity text should focus on the linkages discussed in 3.3, above rather than dwell on the linkages among *capitals*, which is too abstract in the absence of a list of indicators tied to each capital. However, it is important to say that the report should avoid a silo presentation of information and should show the interconnectedness of the topics discussed in 1.3, above and explain how the organization uses value-driven management to address these topics in an integrated way. Innovative approaches too showing this linkage, such as Baxter International's annual Environmental Financial Statement (see www.Baxter.com and Appendix B, below), should be encouraged, and the IICR should say that it will periodically evaluate and publish best practices in this regard.

4. Further Considerations

4.1 Timeframe; More Frequent e-Communications. It is agreed that the time horizon for an integrated report will be longer that for current financial reports. Indeed, sustainability is about establishing and sustaining long-term well-being. But in another sense, reporting may bring out shorter term horizons, especially if the organization follows the trend of using Twitter, blogs and other e- approaches to provide stakeholders more frequent updates on direction, issues and performance. In any event, the relationship

between the report and these other potential methods of communication should be highlighted.

4.2 Explanatory Disclosures. The Framework should include guidance on how a part of the report on Management's Discussion & Analysis (DMA) or a Disclosure on Management Approach (GRI terminology), can be most effectively used to explain issues, performance, and future plans in a succinct, balanced, and useful way.

Appendices

Appendix A: A Company Commitment to Sustainability

Appendix B: Method for Calculating Savings and Cost Avoidance for Baxter's Environmental Financial Statement

Appendix A
A Company Commitment to Sustainability
(A model sustainability policy)
(Consensus of 16 major North American-based multinational corporations)[2]

Vision: It is in the best interest of our company and society as a whole that our company moves along the path to sustainability. To that end, we commit to achieve the following vision of performance:

1. Economic success: the wise use of financial resources

a. Company Economic Prosperity

Our business will be positioned to survive and prosper economically.

b. Community Economic Prosperity

We will help our community survive and prosper economically.

2. Social responsibility: respect for people

a. Respect for Employees

We will treat our employees in a respectful, fair, non-exploitative way, especially with regard to compensation and benefits; promotion; training; open, constructive dialogue with management; involvement in decision-making; working conditions that are safe, healthy, and non-coercive; rights of association, collective bargaining, and privacy; employment-termination practices; and work-life balance.

b. Diversity, Fair Hiring Practices

We will promote diversity and use hiring practices for our employees, management board, and suppliers that are fair and responsible and do not discriminate on the basis of

[2] Model policy was drawn from the following sources: William R. Blackburn, *The Sustainability Handbook—The Complete Management Guide to Achieving Social, Economic, and Environmental Responsibility*, Environmental Law, 2007, Institute, pp.24-25. Sixteen North America-based multinational corporations confirmed this model policy generally captured stakeholder expectations of companies seeking sustainability. See William Blackburn, "Going Green: Corporate Commitment to Citizenship and Sustainability Issues Takes on a Greater Role," *The Conference Board Center for Corporate Citizenship and Sustainability*, Executive Action Series #260, Mar. 2008.

factors such as gender, sexual orientation, religion, age, disability, ethnicity or race, that are unrelated to the requirements of the job.

c. Responsible Governance

We will manage our risks properly, use our economic power responsibly, and operate our business in a way that is ethical and legal.

d. Respect for Stakeholders

We will be transparent, respectful, and fair to local populations, investors, suppliers, and other stakeholders outside our organization who may be affected by our operations. We will work collaboratively with our communities, governments and supply chain to enhance the well-being of others.

e. Fair Dealing with Customers

We will be honest and fair with our customers, competing fairly for their business, respecting their privacy, anticipating their needs, and providing them safe and effective products and services under the conditions we promise.

3. Environmental responsibility: respect for life; the wise management and use of natural resources

a. Resource Conservation

We will conserve our use of natural resources to the extent practicable.

b. Waste Prevention and Management

We will reduce to the extent practicable the quantity and degree of hazardous waste we generate from our operations, and handle it in a safe, legal, and responsible way to minimize adverse environmental effects.

c. Environmental Risk Control and Restoration

We will minimize the risk of spills and other potentially harmful environmental incidents, restore the environment where damaged by us, and enhance it to better support biodiversity.

d. Reduction of Supply Chain Impacts

We will work with others in our supply chain to help assure that adverse environmental impacts and risks associated with our products and services will be reduced and properly controlled, and that environmental benefits will be optimized.

e. Collaboration with Communities

We will collaborate with our communities to protect and improve the environment.

Appendix B
Method for Calculating Savings and Cost Avoidance for Baxter's Environmental Financial Statement[3]

Since 1994, Baxter International Inc, a large global manufacturer of medical products, has been publishing an annual Environmental Financial Statement as part of its Sustainability Report. This Appendix B demonstrates how savings and cost avoidance are usually calculated for that statement. As used in the statement, *savings* has its ordinary meaning: the reduction in actual cost between the report year and the prior year. When costs go up, savings is negative. *Cost*

[3] Source: William R. Blackburn, *The Sustainability Handbook—The Complete Management Guide to Achieving Social, Economic, and Environmental Responsibility*, Environmental Law Institute, Appendix 5, 2007. Baxter's annual Environmental Financial Statements can be found at http://www.baxter.com with the environmental, health and safety information for its sustainability reports.

avoidance, on the other hand, is the additional cost, other than the report year's savings, that was not incurred but would have been if the waste reduction activity had not taken place. Figure B.1 below presents a scenario demonstrating how savings and cost avoidance are computed.

Figure B.1. Example of Waste Savings and Cost Avoidance Calculations

Scenario assumptions:

- **Base Year:**
  Waste disposal cost= $1,000
  Waste material cost= $9,000
- **Annual Changes in Years 1 & 2:**
  Production increase= 10%/yr.
  Waste reduction= 15%/yr.
  Per-unit disposal cost increase= 5%/yr.
  Per-unit material cost increase= 7%/yr.

Financial Measure	Report Year		
	Base Year	**1**	**2**
a. Waste cost (material + disposal)	$10,000	$9,079	$8,242
b. Savings	---	921	837
c. Cost avoidance due to waste-reduction project initiated in report year	---	1,748 (From Project 1)	1,587 (From Project 2)
d. Cost avoidance due to waste-reduction project in prior year	---	---	3.136 (From Project 1)
e. Total savings and cost avoidance (b+c+d)	---	$2,669	$5,560

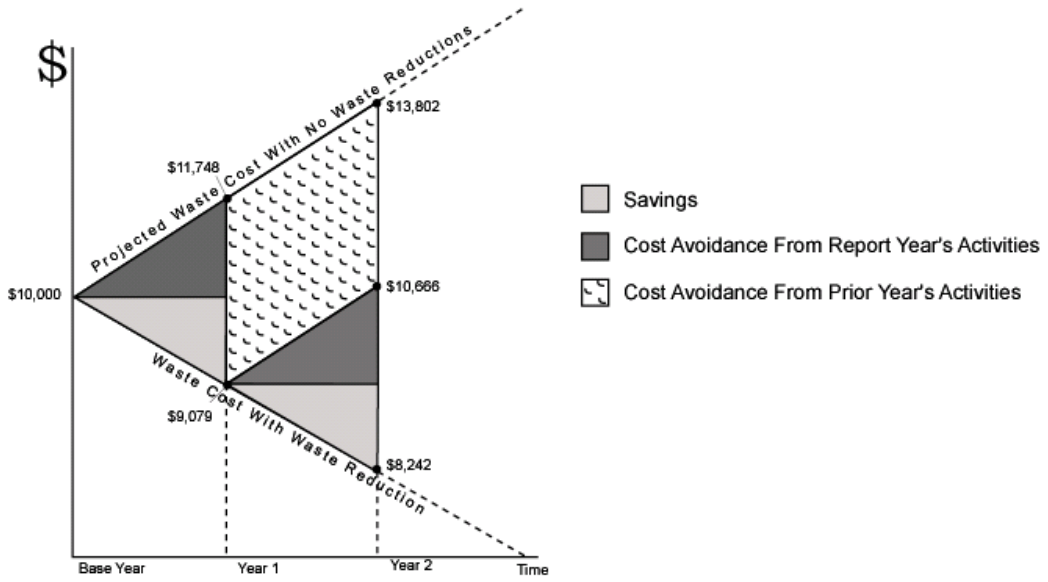
The scenario assumes that in our base year, the waste disposal cost was $1,000 and the cost of the material in the waste was $9,000, making the total cost of waste $10,000. If production increases 10% in year 1, waste volumes would normally go up the same percentage. If, in addition, waste disposal costs per ton increase 5%, the cost of waste disposal in the first year would be: $1,000 × (1 + 0.10) × (1 + 0.05) = $1155. With a 10% production increase and a 7% increase in the price of the material, the value of material wasted in the first year is $9,000 × (1 + 0.10) × (1 + 0.07) = $10,593. Adding the two amounts gives the total cost of waste in year 1, which is $1,155 + $10,593 = $11,748. So if no waste reduction projects are initiated, we will see a $1,748 increase in the cost of waste.

In our scenario, however, we improve our production process so that even with the production increase, our waste quantities in year 1 are 15% lower than in the base year. This

means our disposal cost in year 1 would be $1,000 × (1 - 0.15) × (1 + 0.05) = $893. Our waste material cost would equal $9,000 × (1 - 0.15) × (1 + 0.07) = $8,186, resulting in a total waste cost in year 1 of $893 + $8,186 = $9,079. The savings would be the base year cost of $10,000 minus the year 1 cost of $9,079, which equals $921. This savings is represented by the gray triangle on the left in Figure A5.2. But that is not the only financial benefit we see from our project. We have also avoided paying the cost increase--$1,748--that we would have incurred if no waste reduction project had been undertaken. This cost avoidance is shown in the diagram as the black triangle on the left. Thus our total financial benefit of the project in year 1 is the savings ($921) plus the cost avoidance ($1,748), or $2,669.

To complicate the problem a little more, we have the same changes in year 2 that we experienced the previous year, namely, another 10% increase in production, 5% increase in per-unit disposal cost, and a 7% increase in per-unit material cost. If we take no action to further cut our waste, our disposal cost would drift up to $893 × (1 + 0.10) × (1 + 0.05) = $1,031 and our waste material loss would rise to $8,186 × (1 + 0.10) × (1 + 0.07) = $9,635, producing a total waste cost of $1,031 + $9,635 = $10,666. In other words, our total waste costs would have risen in year 2 by $10,666 - $9,079 = $1,587.

Figure A5.2
Cost Avoidance and Savings Concepts



Once again, however, in year 2 we implement a second project that cuts our waste another 15%. This means our disposal cost in year 2 would be $893 × (1 - 0.15) × (1 + 0.05) = $797. Our waste material loss would be $8,186 × (1 - 0.15) × (1 + 0.07) = $7,445. This leaves us

with a total waste cost in year 2 of $797 + $7,445 = $8,242. Our savings for year 2 would be $9,079 - $8,242 = $837, represented by the gray triangle in the lower right of Figure A5.2. We also have cost avoidance in that year because we didn't have to pay the $1,587 increase that would have been incurred had we not pursued our second project. This is depicted as the black triangle in the lower right of our diagram. Our total financial benefit in year 2 due to our second project would be the savings ($837) plus cost avoidance ($1,587), or $2,424. But in that year we are still reaping the benefit of the first waste-reduction project. If we hadn't undertaken either project 1 or 2, our year 3 waste disposal cost would have climbed to $1,155 × (1 + 0.10) × (1 + 0.05) = $1,334, and our waste material loss would have reached $10,593 × (1 + 0.10) × (1 + 0.07) = $12,468 for a total waste cost of $13,802, as shown on the top line in Figure A5.2. Remember that if we hadn't completed the second waste project in year 2, our total waste cost would have been $10,666. So the continuing effect (cost avoidance) of the first project in year 2 is $13,802 - $10,666 = $3,136. This is represented in the pattern area of the graph in Figure A5.2. Therefore, the total financial benefit in year 2 from both projects can be calculated by adding savings ($837), plus cost avoidance from project 2 undertaken in year 2 ($1,587), plus cost avoidance in year 2 from project 1initiated the previous year ($3,136). This gives us a total benefit in year three of $5,560.

For a company like Baxter where each factory makes many different products, the companywide production growth rate is determined by using the rate of growth in cost of goods sold (COGS) as adjusted for inflation and inventory changes. Inflation adjustments are based on a blend of three relevant U.S. Producer Price Indexes. Once the growth rate is calculated for the year, it is averaged with those determined for the two previous years. This rolling three-year average is used in the calculations to avoid distortions due to startups and delayed environmental effects from production changes. The three-year rolling average used for 2004 was 8%; the one for 2003, 9%; and 2002, 7%.