

The Framework

Objective

1. To note progress on topic-specific Background Papers
2. To review the draft Consultation Draft of the Framework; in particular to:
 - (a) Consider key technical issues and recommend submission of the Proposed Framework (amended as necessary) to Council
 - (b) Provide direction to the Secretariat on consultation questions and other aspects of the Consultation Draft.

NOTE: THE PAPERS FOR THIS AGENDA ITEM WILL BE POSTED TO THE IIRC WEBSITE DURING THE WEEK BEGINNING MONDAY 4 FEBRUARY 2013 IN ACCORDANCE WITH THE IIRC'S DUE PROCESS¹

Proposed actions

In advance of the meeting

3. To help focus on key issues during limited time available at the meeting, Working Group members are asked to review the Consultation Draft and notify the Secretariat in advance of the main issues they would like to discuss.²

During the meeting

4. The Working Group will be asked to discuss key technical issues and to then vote on submitting the Proposed Framework to the IIRC Council, amended as necessary to reflect significant changes, if any, as determined by the Working Group. In order to proceed, the Proposed Framework must be *"recommended to the Council by at least two-thirds of the Working Group present or represented at a meeting (or if voted on out-of-session, is dissented to by no more than one third of the total membership). The reasons for dissenting votes, if any, are communicated to the Council prior to its vote"*.
5. While the intention of the meeting will not be to wordsmith the Consultation Draft, it will help focus the discussion greatly if comments during the meeting can be related to specific text as far as possible.
6. Discussion in the meeting will proceed on the basis that all members have read this covering memo and the Consultation Draft prior to the meeting.

After the meeting (by 19 February 2012)

7. Notify the Secretariat of any editorial or specific wording suggestions.

Topic-specific Background Papers

8. At the time of writing, the work of the Technical Collaboration Groups (TCGs) in preparing topic-specific Background Papers on business models (lead by IFAC, CIMA & PWC, the capitals (ACCA and NBA), connectivity (WICI), materiality

¹ The Due Process states "As of 2013, technical agenda papers of the Working Group and the Council will be published on the IIRC website in advance of meetings, and a recording of those meetings or a summary of discussions will be placed on the IIRC's website within a reasonable time thereafter".
<http://www.theiirc.org/wp-content/uploads/2012/11/IIRC-Due-Process-25-09-12.pdf>

² Please send to Michael Nugent at michael.nugent@theiirc.org or call on +44 (0)74 2515 7728.

The Framework

(AICPA), and value creation (EY) was approaching completion. The Background Papers are expected to be published towards the end of February, and will include a preface along the following lines:

The Technical Task Force of the IIRC established and provided direction to Technical Collaboration Groups (TCGs) to assist in developing the International <IR> Framework. The TCGs prepared the background papers on the key topics noted below. Each TCG was coordinated by a lead organization(s) with input from participants from a range disciplines and countries. Accordingly, each paper varies in form, style and type of content, and reflects the collective views of TCG participants, not necessarily those of their organizations or the IIRC.

The IIRC considered interim findings from the TCGs when preparing the Prototype Framework released in November 2012, and is further considering these papers in developing the Consultation Draft to be released in April 2013. These papers provide background information that will assist stakeholders when responding to the Consultation Draft.

9. An oral update will be provided at the Working Group meeting.

Consultation Draft

10. Since the previous Working Group meeting, the Technical Task Force (TTF)³ and technical staff⁴ have held six 2-hour conference calls and one 2-day meeting.
11. The of the Prototype Framework reviewed by the Working Group at its previous meeting was revised taking account of feedback from Working Group members and Pilot Programme participants. The final Prototype Framework was approved by Council and published in November 2012⁵.
12. The draft Framework has been further revised to reflect the work of the TCGs and the deliberations of the TTF.
13. The main changes since the Prototype Framework and other key issues are noted below for discussion by the Working Group.

Requirements

14. Requirements have been identified in bold italic type throughout the current draft. Paragraphs 1.14-1.15 explain the importance of the requirements. The intention is to keep a principle-based approach while:
 - (a) Protecting the integrity of the Framework by setting a minimum bar for reports that purport to be in accordance with it

³ Alan Knight, Alan Teixeira, Alexandre Nakamaru, Bob Laux, Charles Tilley (chair), David Matthews, Jeanne Ng, Leigh Roberts, Martijn Bos, Nelmara Arbex, Ralf Frank, Roger Simnett, Stephane Voisin, Stephen Kibsey, Susana Penarrubia, and Yoichi Mori.

⁴ Beth Schneider, Kylie Dumble, Lois Guthrie, Mariko Mishiro, and Michael Nugent, with assistance from Lisa French.

⁵ <http://www.theiirc.org/resources-2/framework-development/prototype-of-the-international-ir-framework/>

The Framework

- (b) Responding to requests from preparers and others who want the "must dos" separated from explanations/guidance.

15. Issues for the Working Group to consider include:

- (a) Is the method of identifying requirements in bold italic type where they appear throughout the Framework appropriate?
- (b) Are any of the identified requirements unnecessary/are there any passages that should be identified as requirements that haven't been?
- (c) Is the explanation in paragraphs 1.14-1.15 appropriate?

Intended report users

16. The Working Group has previously agreed that while the communications that result from <IR> will be of benefit to a range of stakeholders, they are principally aimed at providers of financial capital. This is stated in paragraph 1.4 of the current draft, where it is followed by a requirement that "Providers of financial capital are therefore the intended users of integrated reports". The term "intended report users" is then used throughout the remainder of the current draft. The purpose of the requirement in paragraph 1.4 is to ensure materiality decisions are focused on the providers of financial capital. It is the same wording as was used in the Prototype Framework.

17. The Working Group is asked to consider whether:

- (a) Paragraph 1.4 should be amended as follows "... Providers of financial capital are therefore the primary intended users of integrated reports. ..."; and/or
- (b) The term "intended report users" should be replaced with "providers of financial capital" wherever it appears in the current draft.

Outcomes

18. Paragraphs 2.4-2.11 of the current draft contain certain significant changes resulting from the work of the Business Model TCG's consideration how to position "Outcomes" in the Framework.

19. Following a brief discussion at the September Working Group meeting, where the issue of outcomes was first raised, the Prototype Framework included outcomes as an explicit and additional part of the "Performance" Content Element, which was renamed "Performance and outcomes". Subsequently, the Business Model TCG gave the matter considerably more thought and concluded that outcomes would best be positioned as an explicit part of the business model itself, which is reflected in a number of places in the current draft, most particularly in paragraphs 2.9, 2.33 and 4.11, and in Figure 2 (which is being professionally designed), which replaces the following diagram that was in the Prototype Framework:

The Framework



20. The new Figure 2, as well as introducing outcomes as part of the business model:
- Makes the flow of capitals through the organization more apparent; and
 - Clearly identifies the fact that some capitals belong to the organization and some belong to others.
21. The Business Model Background Paper contains an additional diagram and accompanying text that explains this in more detail. The most recent draft of that diagram and text, at the time of writing, is included here as Appendix A.
22. Largely as a consequence of these changes, definitions of “performance” (an organization’s achievements relative to its strategic objectives, and its outcomes in terms of its effects of on the capitals) and “outcomes” (the internal and external consequences for the capitals as a result of an organization’s activities and outputs) have been added to the Glossary, and the name of the “Performance and outcomes” Content Element has reverted back to “Performance” (there has not, however, been any consequential need to change the description of what this Content Element entails).
23. The Working Group is asked to consider whether:
- It is appropriate to include the concept of “outcomes” in the Framework, and if so, is it correctly positioned and described in the current draft; and
 - The diagram or any of the accompanying explanation in Appendix A should be included in the Proposed Framework.

The capitals

24. The descriptions of some of the capitals have changed, although the changes are relatively minor except perhaps the change to the description of intellectual capital, which now explicitly recognises it as “organizational, knowledge-based intangibles” that includes “organizational capital’ such as tacit knowledge, systems, procedures and protocols”.
25. The diagram at Figure 3 (beneath paragraph 2.16) has been added.
26. The definition of “capitals” in the Glossary has been changed to “Stores of value that an organization can use in the production of goods or services but which

The Framework

are not used up immediately in that process” (from “Stores of value on which all organizations depend for their success as inputs, in one form or another, to their business model, through which they are increased, decreased or transformed”).

Value creation

27. The following statement has been added to paragraph 2.41 to reflect a sentiment often expressed by investor representatives in particular “... it is not the purpose of an integrated report to measure the value of an organization, but rather to provide information that enables the intended report users to assess the ability of the organization to create value over time”.

Materiality

28. The Prototype Framework included a 2-part definition of materiality. Under that definition, a matter would be considered material for inclusion in the integrated report if it “could substantively influence the assessments and decisions of the organization’s highest governing body, or change the assessments and decisions of intended users with regard to the organization’s ability to create value over time”. Concerns were raised as to whether the matters that would substantively influence the highest governing body’s assessments and decisions is too low a threshold for matters to be included in an integrated report. There were also questions as to who the highest governing body is in different jurisdictions.
29. Under the definition included in the current draft, a matter is material only if it important to the intended report users. This single focus on intended report users is consistent with materiality definitions in other reporting Frameworks.
30. Another facet of the materiality definition that the Working Group may wish to discuss is inclusion in the final few lines of paragraph 3.23 about whether a the matter substantively affects, or has the ability to affect “the organization’s strategy, its business model, or one or more of the capitals it uses or affects”. It has been suggested that this could perhaps be changed to “the organization’s strategy, governance, performance and prospects” to be consistent with the definition in paragraph 1.2. The rationale for excluding governance, performance and prospects from the materiality definition is the view that the effects of such matters would be effectively encompassed in substantive effects on strategy (e.g., it is not the changes in governance that is material but rather the implications of governance changes on strategy and the business model) and likewise, performance and prospects would be covered by sustentative effects on the capitals.
31. Also, the Prototype Framework had required that a description of the organization’s materiality determination process be included either in the integrated report or elsewhere and reference in the report. This has been changed in the current draft (paragraph 3.37) to require disclosure of the process in the integrated report.

Content Elements

32. The order of the Content Elements has been changed as follows.

The Framework

<i>Prototype Framework</i>	<i>Current draft</i>
<ul style="list-style-type: none"> • Organizational overview and operating context • Governance • Opportunities and risks • Strategy and resource allocation • Business model • Performance and outcomes • Future outlook 	<ul style="list-style-type: none"> • Governance • Business model • Organizational overview and operating context • Opportunities and risks • Strategy and resource allocation • Performance • Future outlook

Organizational overview and operating context

33. "Competitive landscape and market positioning (considering factors such as the threat of new competition and substitute products or services, the bargaining power of customers and suppliers, and the intensity of competitive rivalry)" has been added as a key disclosure in paragraph 4.17 to reflect its importance to the investment community.

External references

34. A question has been raised about whether the Proposed Framework should cite external references and, if they are cited, what criteria should be applied in selecting the ones to include.

35. The criteria noted in the recent "G4" Consultation Draft for including references in the GRI Guidelines are:

- The organization provides publicly-available information about the development process of this reference
- The reference was developed using a collaborative, representative, robust, and transparent process; or developed in an inter-governmental setting
- The reference is generally applicable
- The reference is applicable to all organizations regardless of size or sector
- The reference is available in English
- The reference is available free of charge
- The reference is current and in use

36. External references are currently cited in footnotes to paragraphs 3.18, 4.7, 4.21, 4.28, 5.15, 5.19 and 5.21 of the current draft. No particular criteria were applied in selecting these references, and not all would meet the criteria above.

37. An alternative to citing references in the Framework may be to include criteria like those above and to ask respondents to nominate references that they think would meet the criteria and be helpful to include either in the Framework or on the IIRC website. An advantage of including references on the website rather than in the Framework is that they can more easily be updated as new standards, guidelines, etc. are issued by others.

The Framework

Other additions/changes

38. *Opportunities and risks*: Paragraph 4.22 has been added as the primary explanation of the "Opportunities and risks" Content Element.
39. *Key Risk Indicators*: References to KRIs at various places in the Prototype Framework have been removed.
40. *Wording*: Quite a number of wording changes have been made to improve the clarity and conciseness of the current draft. This is most evident in the paragraphs dealing with business model (2.24-2.33), materiality (3.23-3.37 and 5.3-5.4) and governance (4.7).
41. *Completeness*: The text regarding costs, competitive advantage and forward-looking information (now renamed future-oriented information) that was previously a separate section called "Other considerations" in Chapter 5, has been moved to become part of the description of completeness (now paragraphs 3.43-3.53).
42. Appendix A: Examples of links between the various capitals, the financial reporting entity and other entities/stakeholders has been added at Appendix A.

Consultation questions

43. The Consultation Draft will include a series of questions on key matters where stakeholders' input would be particularly welcome. A number of principles have been identified to guide development of the questions:
 - (a) The total number of questions should be relatively small. Although respondents will not be required to answer all questions, too many questions could be off-putting.
 - (b) The questions will be used as the basis for collating responses, so they should offer the opportunity to comment on all major sections of the Consultation Draft. Therefore, we should have at least one question on each of Overview, Introduction to the fundamental concepts, The capitals, The business model, Creating value, Guiding Principles, Content Elements, and Preparation and presentation (total = 8)
 - (c) There should be some questions about implementation, not just technical correctness (e.g., practicality of application by smaller listed companies).
 - (d) Questions should be neutral (i.e. not leading to a "desired" answer).
 - (e) Open or closed questions: traditional wisdom is that open questions elicit more informative answers. But it can be harder to identify and code themes from open answers. On the other hand, collation of statistics from closed questions can be misleading (e.g., if structured: "do you agree, if not please explain", it forces people who have only a minor qualification to answer "no" so they can add qualitative feedback, which skews the statistics). The preliminary view is to go for a mix of open and closed questions because we need to collate and analyse responses quickly. It is likely that graded answers will be used for the closed questions, e.g., (a) agree, (b) agree with minor qualification, (c) agree with major qualification, (d) disagree; and that reasons will always be requested.
 - (f) At least some questions should target specific groups (e.g., preparers, investors, other report readers, policy-makers, and auditors).
44. The Working Group is asked to review the preliminary list of questions in the

The Framework

draft Consultation Draft and consider whether:

- they are the right question to ask, in terms of (i) content, (ii) tone, and (iii) structure;
- there are any important questions missing.

The Framework

**Extract from the most recent draft of the
Business Model Background Paper**

31. The foundation for the business model disclosure is the flow of capitals through the organisation. Every organisation requires one or more of the capitals as inputs to its business model. These capitals are then consumed or transformed by activities that produce a range of outputs. Whether these outputs create or destroy value depend upon the outcomes they generate. For instance manufacturing a product that appeals to customers will create demand and generate revenue; whether that demand is profitable depends upon the market price that the product can command and the cost structure implicit in the entire supply chain. In the longer term factors such as customer satisfaction, innovation, organisational reputation, ethical business activities, and environmental impact are all likely to affect brand loyalty and the value creating potential of the organisation.
32. Fundamental to effective integrated reporting is the potential trade-off between short-, medium- and long term effects and also between positive and negative impacts on the six capitals. For instance, depletion of non-renewable raw materials (such as by the extractive industry) can reduce the value generated by the organisation as perceived by society, however, the financial return coupled with environmental impact mitigation activities may be considered to more than offset this. An effective integrated report should disclose such trade-offs and consider how the position is likely to develop over the long term.
33. This view of the business model interacting with the capitals, both internal and external to the organisation, can be expressed in the form of the diagram shown in Figure 6. The six capitals are all potentially inputs to the business model, and each can be either a direct input (e.g., cash used in transactions, labour, raw materials) or an indirect input (e.g., education of the workforce, transport infrastructure, regulatory and legislative parameters). In some cases, the organisation does not bear a specific charge relating to its use of a capital, such as environment or common societal assets like the road network. The combination of costs borne by the organisation and those borne by broader stakeholders (labelled "society" in Figure 6) are represented by the cog marked "shared costs".
34. The core of the business model is the value adding activities of the organisation (represented by the central cog in Figure 6) which, through the consumption and/or transformation of inputs into desirable outputs, aims to generate valuable outcomes.
35. The value-adding activities of an organisation can also have a direct effect on the outcomes of the business model independent of the outputs. For instance, ethical manufacturing procedures may have a positive outcome in terms of corporate reputation. This is represented by the dashed line.
36. Outputs are typically recognised to be the products and services that are intended to generate revenue for the organisation. However, there are potentially other outputs that need to be considered such as waste and other by-products, which may need to be discussed within the business model disclosure.
37. As with inputs, outcomes can be either internal or external to the organisation: profits, cash flow and corporate reputation are examples of internal outcomes; customer satisfaction, employment opportunities, taxes and environmental impact are examples of outcomes flowing to society (including customers, without whom no business can continue to create value). From an input point

The Framework

of view, the capitals either belong to the organisation or to broader stakeholders (society). Similarly, the benefit of value created by the organisation is “shared” between society and the organisation (the third cog in Figure 6).

38. Assessing targeted or desired outcomes against strategic objectives may lead to changes to the value adding activities and potentially the strategy of the organisation. Additionally, consideration of the whole value chain rather than just what is currently owned or directly controlled by the organisation may highlight that current performance and strategy cannot be sustained over time without a change in the business model because value creation is a cycle in which the stock of capitals at the end of a period become the capitals available for use by the business model in the following period (as represented by the dotted line).

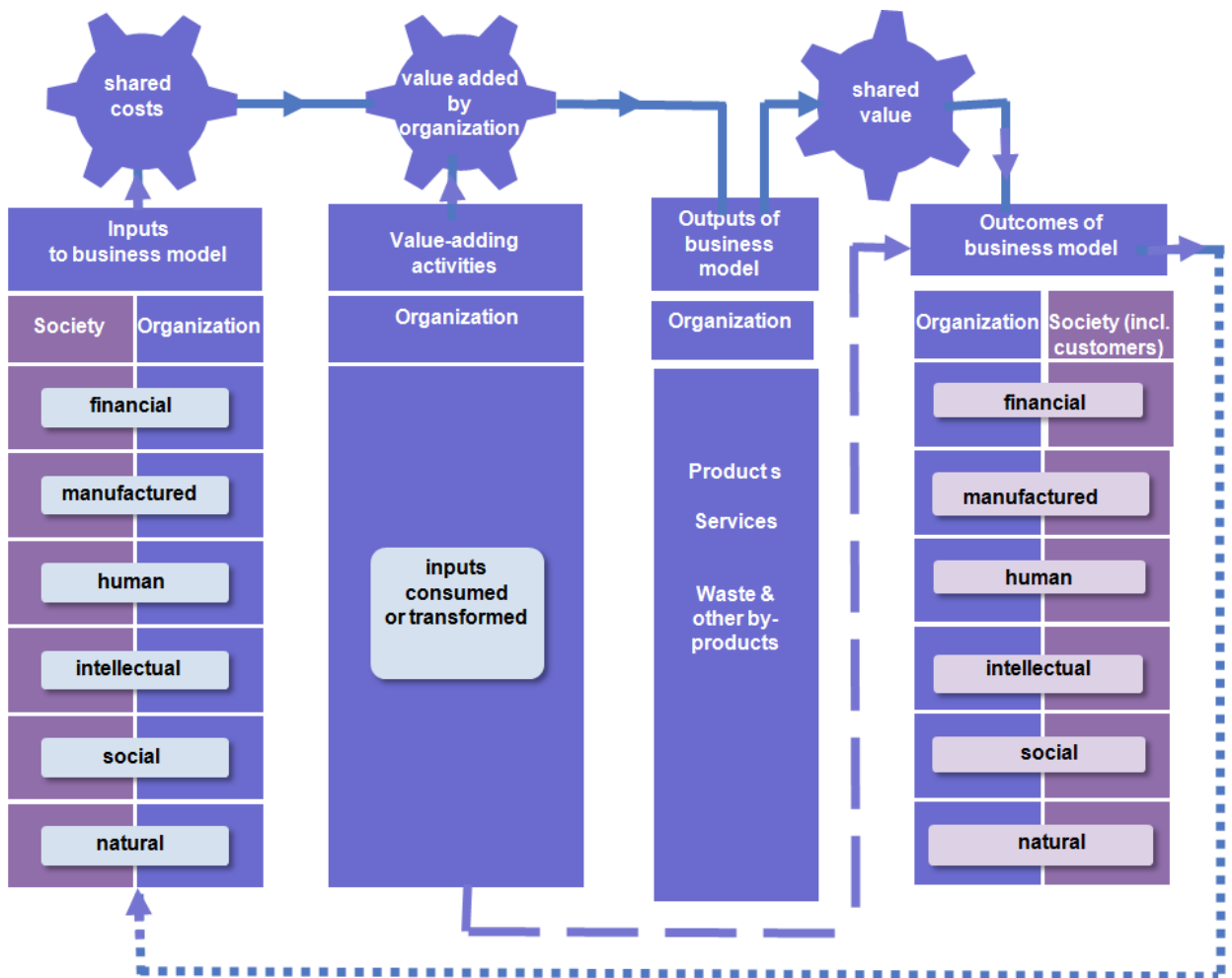


Figure 6. Interaction of business model with internal and external capitals