

Integrated Reporting consultation

Response from Matthew Leitch

(Please note: Adobe Acrobat Reader told me it would not save the consultation form with data included, so I have pasted my answers into this file instead.)

Summary

Overall this is an interesting and helpful document. I particularly like the underlying model of stocks, flows, and the business model. It's a step up from the usual vague talk about business models, yet without blinding us with system dynamics.

However, the material on 'risks and opportunities' does not fit the picture and should be replaced by material more appropriate to the underlying model. The phrase "risks and opportunities" has become shorthand in risk management and regulatory circles for lists of good and bad things that might happen in future. Businesses generally do not make plans on this basis - at least not important plans. They are more likely to have in mind their value creation process, around which there is uncertainty. That uncertainty means that future outcomes might be worse than their best guess (i.e. 'risks') or better than their best guess (i.e. 'opportunities').

(This is a topic we have discussed at length on the Risk Management committee (RM/1) of the British Standards Institution.)

Since the Draft Framework sets out a clear set of concepts for the value creation process you are in a great position to express guidance on 'risk' in terms of that underlying model and avoid the shortcomings of the 'risks and opportunities' jargon.

Instead of talking about 'risks and opportunities' recommend discussion of the major uncertainties around the value creation process. This would include uncertainty about the future environment, uncertainty about future outputs, uncertainty about future outcomes, and uncertainty about elements of the causal model that links the business activities to outputs and to outcomes.

Reporting organizations could explain their model, what is inherently difficult to predict and why, how they go about prediction, how they factor in the impact of their own activities, what they are doing to learn more about their environment and how their actions lead to good outcomes, and what remains uncertain about the future. This would include discussion of all the capitals and somewhere in there, surely, would be such traditional concerns as health, safety, pollution, and financial ruin.

Not only is there a great opportunity to write something wonderfully helpful, but if this is not done the text on 'risks and opportunities' will make things worse than they are now. Organizations have been told over and over again by corporate regulations to identify their risks and manage them. This has led to a tendency to try to manage risk using a new, separate activity called risk management that involves making lists of 'risks' and deciding what to do about each one. The resulting bureaucracy of risk registers and heat maps has added little and distracted people from dealing with risk in

core management activities such as business planning, business design, decision making, evaluation, and sense-making.

We need to get risk/uncertainty dealt with competently within core management activities, not encourage people to shift it even further away into separate meetings, agenda items, documents, and roles. The Integrated Framework provides an excellent opportunity to point people in the right direction.

1. Principle 4C should be completely re-written to say:

An integrated report should answer the question: What is uncertain about the value creation process of the business in the short, medium and long term, and how is the organization responding to this uncertainty?

The supporting text should be rewritten to reflect this perspective and avoid talk of 'risks and opportunities'. In particular, there should be no encouragement to make lists of risks and opportunities and no encouragement to rate each for its 'probability' and 'impact'. Although these ratings have become common in some risk management exercises they are not appropriate for management of a large enterprise. More thought and clarity are required where the stakes are so high.

5. This is a good framework. It is broader than most and puts a healthy emphasis on having a clear mental model.

7. Yes. As business definitions go this is a good definition.

8. I think I understand the intention, but in effect this just says that outcomes = consequences. It is only a step forward if you know what consequences are. Time scale could be worth mentioning.

11. This comment relates to section 5B. The idea of rating matters on their magnitude and likelihood of occurrence repeats a common mistake in risk management. The issue is that the potential magnitude of a matter usually varies over a range, often wide. A more helpful way to look at it is to consider the likelihood of the magnitude being greater than one or more thresholds. The thresholds are chosen to help with filtering out the most important matters.

People find this less confusing, in practice, because with the magnitude and likelihood approach they wonder how they can select a magnitude when it obviously is not one number, and they are confused when the likelihood of occurrence is 100%, forgetting that there is still uncertainty as to the magnitude.

14. 3.32 suggests that if you don't have reliable information on some topic then you should not give any information about it. It would be better to encourage objective disclosure of measurement uncertainty and encourage people to say what they can, albeit with ranges and so on.