

## **Comments for the Consultation Draft of the International <IR> Framework**

July 12th, 2013  
Caux Round Table Japan

Caux Round Table Japan jointly hosted the International <IR> Framework Public Comment Workshop with Ernst & Young ShinNihon LLC in Tokyo on June 28th. The workshop involved an interactive session where a group of 28 Japanese participants consisting of company representatives, CSR experts and consultants presented their expectations and concerns regarding the Consultation Draft of the International <IR> Framework (<IR> Framework).

This report summarises the suggestions and comments made at the workshop. We believe that these “real voices” of companies could contribute to further improvement of <IR> Framework, helping to understand how companies, the primary users of the Framework, view integrated reporting.

### **Discussion Summary**

- I. Expectations
- II. Concerns
- III. Issues to be discussed

#### **I. Expectations**

1. <IR> Framework could be a useful management tool that helps top management to develop long-term business strategies.
  - Identification of business models, capitals to be considered from a long-term perspective, as well as risks and opportunities based on <IR> Framework, would provide valuable assistance to top management to develop strategic management thinking.
  - Considering this function of <IR> Framework, it seems better to define it not as a mere reporting tool but as a management tool. This would make it easier for users to understand its aims and intentions.

【Reference: Consultation Question (CQ) 18/ Consultation Draft (CD) 1.5, 5D】
2. <IR> could be a useful investor engagement tool, benefiting both report users (investors) and information providers (companies).
  - Merit for investors:  
It is difficult for investors to assess the soundness of corporate management only through traditional measurements such as screening. <IR> could be an effective engagement tool enabling them to obtain a comprehensive understanding of the company.

- Merit for companies:  
 <IR> could allow a company to meet investors who have an understanding of and empathy toward the company's visions and mission.  
 【Reference: CQ24/ CD 1.5, 3C】

### 3. Japanese companies could make the most of its strengths

Japanese companies traditionally have long-term perspectives, and give consideration to qualitative aspects of corporate management, including quality, human resources, and the environment. It is expected that <IR> Framework may allow them to make the most of their strengths.

【Reference: CQ24】

## **II. Concerns/ Suggestions**

### 1. Positive impacts on society brought out of <IR> should be more clearly indicated.

Although it is understandable that “an integrated report should be prepared primarily for providers of financial capital in order to support their financial capital allocation assessments”(1.6), the emphasis on business values, such as corporate values and capital, seems to weaken the merit of integrated reporting in terms of social value creation, such as the contribution to sustainability and the resolution of social issues.

Though the draft shows the linkage between the interests of financial capital providers and other stakeholders, stating that “those providers of financial capital who take a long term view of an organization's continuation and performance are particularly likely to benefit from <IR>. Their interests are likely to align over time with the interests of other stakeholders because both are focused on the creation of value in the short, medium, and long term” (1.8), we think that there are gaps between the interests of investors and other stakeholders. Considering the current condition in which most investors still focus on short-term performance and business value creation, top management consequently do not recognize the need for integrated reporting, <IR> Framework should deliver a much clearer message of why integrated reporting is needed from the perspective of long-term social value creation.

【Reference: CQ6, CQ12/ CD1.6, 2B】

<Comments from participants>

- Social and Relationship Capital and Natural Capital are naturally seen as benefitting the public. Integrating them as forms of corporate capitals is likely to undermine the positive perspective from which they are usually seen.
- Setting goals in terms of a “value creation = long term value creation for investors” equation seems to highlight the importance of business value creation, while neglecting social value creation.
- The International codes of conduct needed to be referenced are unclear. It is not obvious how reporters ensure consistency with them (e.g. human rights).

- I do not think that the draft of <IR> Framework could motivate companies to contribute to social value creation.
2. The role of management and the need for leadership should be clearly indicated.  
 Since an integrated report requires reporting on corporate strategy, it is inappropriate and impossible to create an integrated report without the commitment of managers. This means that the quality of an integrated report largely depends on competence of management; in other words, the extent to which they adopt “integrated thinking”. However, in reality, the level of understanding of integrated reporting held by many members of top management is still low. If <IR> Framework is issued as a guideline in such a situation, there is likely to be considerable risks that many “integrated” reports without substance would be issued.  
 Therefore, <IR> Framework should more clearly indicate the role of management and the need for their leadership in order to raise awareness on “integrated thinking” among managers and to encourage them to embed it within their management. (“5D Involvement of those charged with governance” is not sufficient).

【Reference: CQ18/ CD5D】

<Comments from participants>

- It seems that a few managers consider both business and social values when making decisions and embed integrated thinking into their management. In such a situation, there is considerable concern that issues of “integrated” reports without substance would cause information overload.
  - It is very difficult to implement the concept of <IR>.
  - How to ensure soundness of corporate strategy is unclear.
  - It is impossible to ensure the quality of an integrated report that involves comprehensive decision making from the long-term perspective, without reviewing the current reporting process, where each department, such as public relations, management planning, CSR/ sustainability, and general administration departments, separately collects information and writes up an article. What is questioned concerning <IR> is not the reporting technique but the soundness of management.
3. More detailed and concrete explanation is needed regarding the process of determining materiality.  
 Determining materiality is a vital part in <IR> process. However, it is likely that the explanation in the draft is too conceptual and abstract for what materiality is and how a reporter should deal with it to be easily understood. The lack of clear explanation may cause users’ understanding and interpretations to vary, which would result in deterioration to the quality of an integrated report. Moreover, the difference in definition of materiality between <IR> Framework and other guidelines such as GRI G4 Guidelines and ISO26000 may cause confusion among users.

It is agreeable that companies should act proactively and conduct materiality assessment through “regular engagement with the primary intended report users to identify their information needs” (3.27), yet more concrete explanations, including points to be considered and examples, are needed in order to prevent arbitrary interpretation and reporting without substance.

【Reference: CQ12/ CD3D】

<Comments from participants>

- It is difficult to determine materiality. It is unclear to what extent a company (reporter) should provide information.
- The difference in definition of materiality between <IR> Framework and other guidelines such as GRI G4 Guidelines and ISO26000 may cause confusion.
- At a holding company (e.g. a general trading company and a logistics company in Japan), it is the individual company comprising a holding that runs business, develops business models, uses capitals, and identifies risks and opportunities. Which is more important to report, the corporate strategy at the holding level, or the business activity at the individual company level?
- Defining boundaries is also very difficult. Is it possible to ensure comparability between financial information and non-financial information that is likely to be beyond financial reporting boundary?

4. Materiality assessment should involve a wider range of non-financial information.

When it comes to materiality assessment (5.6), the draft says that “both its magnitude and its likelihood of occurrence are considered to assess its importance” (5.10). The evaluation criteria, which are likely to be based on the risk approach in financial reporting, seem to make it difficult to deal with non-financial information, or to limit the scope. Moreover, in the first place, if likelihood can be measured, it could be dealt with within the existing risk management framework. Considering the significance of integrated reporting is communicating with stakeholders about how the company views social and environmental events that are beyond easy measurement, the concept of materiality should be defined in a much wider context. In addition, negative risks tend to be emphasised when assessing materiality from the perspective of likelihood. It is also important to consider the positive aspects from the perspective of accumulated capitals and opportunities.

【Reference: CQ12/ CD5B】

5. More concrete explanation of what information investors (report users) need should be provided.

Although it is understandable that report contents should be defined through “regular engagement with the primary intended report users to identify their information needs” (3.27), the fact is few investors evaluate companies from a long-term perspective in consideration of non-financial information. Moreover, all investors are not the same in

terms of investment objectives and intentions. It would be too burdensome on companies to deal with such diverse interests and to determine report contents in alignment with a brand new reporting framework (<IR> Framework). This may result in arbitrary interpretation of <IR> Framework and creation of an integrated report that provides only information that the company wants to publicise. Therefore, <IR> Framework should provide more concrete explanation of what information regarding long-term value creation and integrated thinking investors (report users) need in order to facilitate the precisely deliver of such information by companies.

【Reference: CQ4/ CD1.6】

<Comments from participants>

- <IR> Framework is too abstract, despite its intention to serve as an aid for investors' decision making. It is expected to show what information investors need more concretely.
- The Framework requires identifying target investors before providing a comprehensive value creation story. However, the way in which a company identifies such targets is unclear.
- It is difficult to identify such report users that <IR> Framework assumes to have in the current situation, at least in Japan, where few investors seem to consider corporate long-term value creation when investing.
- In the first place, integrated reporting is required to respond to the needs of investors who have long-term perspectives and integrated thinking. If the aim of <IR> Framework becomes to make investors obtain a long-term perspective and integrated thinking by promoting <IR>, it seems to confuse aim and means.

6. Others

- It is expected that <IR> Framework shows an evaluation criteria for a different time frame.

Both investment decisions and capitals could change according to the time frame. It is not sufficiently clear how to report the changes.

【Reference: CQ24/ CD5F】

- Ensuring comparability seems difficult.  
Evaluation criteria for material information could differ according to culture and society. For instance, recognition on human rights differs between countries. This could cause the information that companies provide to vary and could make it difficult to ensure comparability.

【Reference: CQ15/ CD3F】

- External assurance on an integrated report seems to be unrealistic.  
It would be almost impossible to conduct external audits and gain assurance on corporate long-term future outlooks and the soundness of management strategy.

【Reference: CQ20/ CD5E】

### **III. Issues to be considered**

We believe these questions that arose due to the Great East Japan Earthquake and following the Fukushima nuclear accident provide crucial insights into further improvement of <IR> Framework.

- What should the companies that operated in the affected area, for example Tokyo Electric Power Company (TEPCO), have prepared and how should the information have been disclosed?
- <IR> Framework requires disclosing material information on issues and events that are low in likelihood of occurrence and high in magnitude of effect. To what extent should information have been disclosed before the nuclear accident?
- When it comes to business carried out as a national policy, for instance nuclear power generation in Japan, companies cannot disclose all the information based on their individual judgments. How should these companies have dealt with such situation?

【Reference: CQ24】

End