Consultation questions

The IIRC welcomes comments on all aspects of the Draft International <IR> Framework (Draft Framework) from all stakeholders, whether to express agreement or to recommend changes.

The following questions are focused on areas where there has been significant discussion during the development process. Comments on any other aspect of the Draft Framework are also encouraged through the questions.

Please provide all comments in English.

All comments received will be considered a matter of public record and will be posted on the IIRC's website (www.theiirc.org).

Comments should be submitted by Monday 15th, July 2013.

Name:	Local Authority Pension Fund Forum
Email:	info@lapfforum.org
Stakeholder group:	Other report users

If replying on behalf of an Organization please complete the following:

Organization name:	Local Authority Pension Fund Forum
Industry sector:	Not applicable
Geographical region:	Western Europe

Key Points

If you wish to briefly express any key points, or to emphasize particular aspects of your submission, or add comments in the nature of a cover letter, then the following space can be used for this purpose. Please do not repeat large amounts of material appearing elsewhere in your comments.

Chapter 1: Overview

Principles-based requirements

To be in accordance with the Framework, an integrated report should comply with the principles-based requirements identified throughout the Framework in bold italic type (paragraphs 1.11-1.12).

1. *Should any additional principles-based requirements be added or should any be eliminated or changed? If so, please explain why.*

Interaction with other reports and communications

The <IR> process is intended to be applied continuously to all relevant reports and communications, in addition to the preparation of an integrated report. The integrated report may include links to other reports and communications, e.g., financial statements and sustainability reports. The IIRC aims to complement material developed by established reporting standard setters and others, and does not intend to develop duplicate content (paragraphs 1.18-1.20).

2. *Do you agree with how paragraphs 1.18-1.20 characterize the interaction with other reports and communications?*

Whilst the integrated reporting 'process' is intended to apply continuously to all relevant reporting, the primary audience of an integrated report as 'providers of financial capital' has been made clear. It should also be borne in mind that the aim of the framework is for a global norm, such that it can support established and developing national regulatory frameworks. In the UK context, Companies should use the IIRC guidance on integrated reporting to help prepare the new 'strategic report' which will be required by companies with reporting years ending after October 2013.

The integrated report should ensure that the most relevant and material information is presented by companies. Although we agree that reporting should be forward-looking, there is still a need for the report to review the actions and decisions taken in the reporting year. Therefore companies should aim as far as possible for full co-ordination with other reporting mediums, for example reporting on material environmental or employee-related factors using relevant performance indicators that cover the same statutory financial reporting period.

In general, shareholders vote on receipt of the report and accounts at companies' general meetings. The integrated report should be included in this ratification process, with shareholders having the ability to support or decline to support an integrated report.

LAPFF would caution against breaking the link of accountability to shareholders for the statutory financial accounts. For example, in the UK, from October 2013, shareholders will only receive a 'strategic' report unless they request a full copy of the report and accounts, instead of the summary financial statements previously provided. This could undermine the cited macro-aims of Integrated Reporting of achieving financial stability and sustainability (Business Leaders: What you need to know, Integrated Reporting, 2013). There is also an inherent danger in straying from existing national laws in an attempt to implement a globally applicable system. LAPFF considers that the problems resulting from global adoption of International Financial Reporting Standards illustrate these unforeseen consequences (http://www.lapfforum.org/TTx2/news/leading-counsel-confirms-substantial-legal-problems-with-ifrs). We caution against recreating the problems we have seen with IFRS by creating another supranational reporting body that is not explicitly grounded in national legal and regulatory regimes.

LAPFF has recently raised concerns about the role of the accounting profession in failing to properly implement Company Law with regard to IFRS. We note that the Parliamentary Commission on Banking Standards has stated that the large accounting firms in their role as auditors failed in their core duties to shareholders in signing-off the accounts of the banks. There may therefore be concerns about the level of representation of the large accounting firms involved in developing the IR design and of their role in providing assurance for IR.

3. *If the IIRC were to create an online database of authoritative sources of indicators or measurement methods developed by established reporting standard setters and others, which references should be included?*

The International Integrated Reporting Council (IIRC) is already a global coalition including regulators and standard setters that has signed memorandums of understanding with the International Federation of Accountants, the Global Reporting Initiative (GRI) and the World Intellectual Capital Initiative. LAPFF would concur that these bodies are themselves authoritative sources of indicators. Additionally, developing nationally based initiatives may also provide valuable input for companies applying the reporting framework, such as the US Sustainability Accounting Standards Board, which is working to providing industry specific guidance on materiality and reporting and Project Delphi which aims to link ESG factors to enterprise value.

Regarding particular measurement methods developed by standard setters:

• LAPFF would support inclusion of the framework developed by Carbon Disclosure Standard Boards which supports improvement of existing standards and practices to link financial and climate change-related reporting.

• LAPFF does NOT endorse International Financial Reporting Standards and IAS 39 in particular (the standard applicable to banks) as it considers the accounting outcomes, particularly for the banking sector have been damaging and are contrary to the true and fair view requirement of UK Company Law.

• LAPFF notes that IFRS 8 (segment reporting) does not allow for geographic reporting, raising concerns about transparency in the extractive industries. The EU has now legislated for "Country by Country Reporting." LAPFF supports this approach to reporting because we think it is relevant to both tax and sustainability issues. Given the financial interest the accounting firms have in providing tax planning service to their clients, we would greatly encourage prudence on the part of the IIRC to ensure country-by-country reporting is included the final Framework.

Other

4. *Please provide any other comments you have about Chapter 1.*

Chapter 2: Fundamental concepts

The capitals (Section 2B)

The Framework describes six categories of capital (paragraph 2.17). An organization is to use these categories as a benchmark when preparing an integrated report (paragraphs 2.19-2.21), and should disclose the reason if it considers any of the capitals as not material (paragraph 4.5).

5. *Do you agree with this approach to the capitals? Why/why not?*

Many of these capitals come under the heading of what has been known as 'intangibles'. Standard and Poors showed that in the 1970s, 80% of a company's market value could be traced through its financial statements, whereas the figure now is closer to 20% of market value being accounted for by a company's financial and physical assets.

The applicability of the different capitals and their management is therefore fundamental to companies' value creation. LAPFF recognises the framework does not set out to provide actual measurements for other forms of capital such as intellectual or human capital, but that it aids and guides companies in reporting information that helps the readers assess the company's ability to create value over time. The development of underlying performance indicators will strengthen this ability.

LAPFF would support the approach of companies such as Randstad Holding N.V., which made its Chief Financial Officers have overall responsibility for non-financial data in 2012. The company noted that placing responsibility for performance indicators with the CFOs was important as these individuals are well-placed 'to see links between them and can implement company-wide processes to gather data. '

For some categories of capital, these indicators are well developed. For others, in particular human and intellectual capital, there remains room for innovation and alternative approaches.

In 2012, LAPFF published 'People and Investment Value'

(http://www.lapfforum.org/TTx2/Publications/latest-research/files/2012_People_and_Investment_Value.pdf) which is designed to guide beneficiaries, investors and their agents in their appraisal of companies' employee value propositions. This built on earlier work of the Forum which recognised the value of human capital, and how investors can value this, with the paucity of relevant information provided by companies (http://www.lapfforum.org/TTx2/Publications/latest-research/files/LAPFFTrusteeGuideUnlockingHumanCapital2007.pdf).

We reiterate that existing standards in the IFRS framework do not, in our view, always provide credible measurement of financial capital and therefore the IIRC should treat these measures with caution.

6. Please provide any other comments you have about Section 2B?

Business model (Section 2C)

A business model is defined as an organization's chosen system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term (paragraph 2.26).

7. Do you agree with this definition? Why/why not?

This definition is accurate and sufficient, although it might be preferable to use the terms 'whose primary aim is to create value', rather than 'that aims to create value'. It might also be useful to make the point that developing the business model is integral to the business strategy (2.8). If the strategy sets out how the company will maximise opportunities and manage risks, the business model must be seen to deliver this strategy. It will also determine resource allocation and planning.

Outcomes are defined as the internal and external consequences (positive and negative) for the capitals as a result of an organization's business activities and outputs (paragraphs 2.35-2.36).

8. *Do you agree with this definition? Why/why not?*

This definition is accurate and sufficient. The additional text of 'outcomes can therefore be …positive' in that they create value by a net increase in the capitals (supplied in 2.35) might better be phrased as 'outcomes sought can therefore be…'

9. *Please provide any other comments you have about Section 2C or the disclosure requirements and related guidance regarding business models contained in the Content Elements Chapter of the Framework (see Section 4E)?*

Other

10. *Please provide any other comments you have about Chapter 2 that are not already addressed by your responses above.*

The purpose of integrated reporting is to communicate information to support report users in their assessments of value creation. This focuses companies on the need to make more explicit the link of various capitals to the business model and business strategy. Investors can then have a more informed basis of discussion with board members of the strategic implications of how companies are managing one or more of these capitals.

LAPFF's experience in the past has been that when engaging with companies on governance or financial concerns, or on a particular incident that has put the company in the media spotlight, board members will make the time to meet. Where the conversation proposed is on topics such as employee concerns or managing climate risk, the meeting is often cascaded down to a below-board level, illustrating the 'silo' mentality. However, this is changing, both by the Forum's increasing focus on engagement over a range of factors affecting company value creation and the drive to support companies' moving to a more strategic form of reporting on the various capitals.

For section 2D, on 'value creation' we note that companies may be unwilling to make certain disclosures on the basis of commercial constraints or that forecasts of expected value could expose directors to liabilities. Companies already using the framework have identified the possibility of 'safe harbour' or 'reduced liability exposure' initiatives to help them formulate their disclosures and address potential risks from their forward-looking nature. It might be helpful to include this in the guidance.

As highlighted above, LAPFF has fundamental concerns with financial accounting standards in recent years, based on International Financial Reporting Standards, which have had a particularly damaging effect on UK and Irish banking sectors. The Forum is currently calling for a full review into how these defective standards were adopted and an investigation into whether the existing regime requires fundamental structural reform (http://www.lapfforum.org/TTx2/news/leading-counsel-confirms-substantial-legal-problems-with-ifrs). For Integrated Reporting to function in any useful way, a reliable base is needed to lay the foundation for any predictions of future value. We do not think IFRS provides a credible basis for predicting future value.

LAPFF supports the approach proposed by Stella Fearnley (FT, 18 June 2013) which calls for companies, under safe harbour provisions, to publish their projected cash flows, profit forecasts and balance sheets based on their latest audited balance sheets and business models. This would ensure that where cash flows do not materialise, ineffective accounting would be evident.

Chapter 3: Guiding Principles

Materiality and conciseness (Section 3D)

Materiality is determined by reference to assessments made by the primary intended report users (paragraphs 3.23-3.24). The primary intended report users are providers of financial capital (paragraphs 1.6-1.8).

11. Do you agree with this approach to materiality? If not, how would you change it?

The approach is for the company to determine whether the matter substantively affects or has the potential to affect the organisation's strategy, business model or one of its capitals. A more prescriptive definition would not be useful at this stage, especially in light of the principle of conciseness and avoiding redundant information. LAPFF considers it appropriate that companies should disclose their own materiality determination process.

12. Please provide any other comments you have about Section 3D or the Materiality determination process (Section 5B).

Some US companies already disclose significant risks in their SEC Form 10-K filings as they are legally bound to. Other companies disclose other risks in a variety of media, such as their separate CSR reporting or in response to specific questionnaires. Reviewing such information in terms of materiality for medium to long-term performance is a useful tool in identifying relevant indicators for the integrated report. Where there are uncertainties surrounding the probability, timing and magnitude of potentially material factors, scenario analysis is a useful technique to capture appropriate risks. This would be useful for disclosure relating to the relative impact of climate change regulatory policies.

Reliability and completeness (Section 3E)

Reliability is enhanced by mechanisms such as robust internal reporting systems, appropriate stakeholder engagement, and independent, external assurance (paragraph 3.31).

13. How should the reliability of an integrated report be demonstrated?

LAPFF considers that the reliability of an integrated report would not necessarily be enhanced by a mandatory formal external verification process, particularly as the emphasis is on a future orientation. However, independent verification on the process undertaken would certainly be of benefit and would offer assurance to investors. See also LAPFF's comments earlier regarding the role of accounting firms in the assurance process.

14. Please provide any other comments you have about Section 3E.

For a report to be reliable, it has been identified that this goes hand in hand with completeness. In the Forums' view, the greatest value lies in the process of analysing how sufficient existing systems are to flag up those areas that require stronger monitoring and management systems, not for a reporting outcome per se.

Other

15. Please provide any other comments you have about Chapter 3 that are not already addressed by your responses above.

In the Forum's view, key elements of the Guiding Principles include linking the organisation's strategies with its KPIs as too often there is a disconnect between business drivers and reported indicators. Stakeholder responsiveness is another key element. Recent studies have shown that the most successful companies are now more pro-active and positively focussed on risk management (Eversheds 2013 board report). Effective stakeholder engagement will ensure directors are reviewing all relevant matters and that long-term material matters are given sufficient weight and not drowned out by the pressure from shorter term, quarterly results driven pressures. Finally, the greater attention given to comparability, the more useful the reporting process will be to report users. This applies to companies by standardising the nature of ratios used wherever possible with their peers as well as using industry benchmarks in their reporting, but also to standard setters, by aligning their indicators (e.g. the Sustainability Accounting Board and Carbon Disclosure Standards Board's 'Consistency project').

Chapter 4: Content Elements

16. Please provide any comments you have about Chapter 4 that are not already addressed by your responses above (please include comments on the Content Element Business Model [Section 4E] in your answer to questions 7-9 above rather than here).

With respect to the section on remuneration and incentives (4.12), the current wording on compensation policies and practices seems to encourage a focus on the link between an organisation's use of capitals and how it arrives at performance based compensation, including fixed and variable components. LAPFF has questioned whether performance-related pay is necessarily effective in motivating directors or aligning their interests with shareholders (http://www.lapfforum.org/TTx2/Publications/latest-research/files/2013MarchExpectationsonPayFINAL.pdf). A more neutral or nuanced phrasing of this section might address current problems with over-complex remuneration schemes and whether pay can truly reflect performance. For example, the first sentence might clarify the scope by being amended to '..an integrated report focuses not only on significant financial compensation policies and practices (….) but also looks at other motivations and incentives that drive human behaviour'.

The Forum would concur with cautioning against 'boilerplate' disclosure (4.16) and that disclosures on opportunities and risk over a range of areas need to be specific and evidence-based. The standard disclosure in annual reports of 'employees are our best asset' is widely and rightly quoted as meaningless and ineffectual reporting. In this regard, demonstrating the connectivity of financial performance with performance regarding other capitals (4.29) would be particularly useful. Thus, disclosure on the expected revenue growth resulting from efforts to enhance human capital is more meaningful and provides better insight into company initiatives and strategy.

Chapter 5: Preparation and presentation

Involvement of those charged with governance (Section 5D)

Section 5D discusses the involvement of those charged with governance, and paragraph 4.5 requires organizations to disclose the governance body with oversight responsibility for <IR>.

17. *Should there be a requirement for those charged with governance to include a statement acknowledging their responsibility for the integrated report? Why/why not?*

Yes, this responsibility should be a requirement. The current guidance notes only that they ‘may’ include such a statement. From a UK perspective, one would assume the soon to be implemented strategic report would form the natural home for integrated reporting. As this report will be sent to all shareholders (in place of summary financial statements) in this context, there should be a statement of responsibility.

18. *Please provide any other comments you have about Involvement of those charged with governance (Section 5D).*

Credibility (Section 5E)

The Framework provides reporting criteria against which organizations and assurance providers assess a report’s adherence (paragraph 5.21).

19. *If assurance is to be obtained, should it cover the integrated report as a whole, or specific aspects of the report? Why?*

If there is a requirement for assurance, and LAPFF does not initially specifically endorse this, it should cover the integrated report as a whole. However, to the extent that national regulations require this assurance, for example in the UK, where the current parallel would be the Business review, assurance should as a minimum follow current standards. Again LAPFF also refers to earlier answers in 2 and 13 above.

20. *Please provide any other comments you have about Credibility (Section 5E). Assurance providers are particularly asked to comment on whether they consider the Framework provides suitable criteria for an assurance engagement.*

Other

21. *Please provide any other comments you have about Chapter 5 that are not already addressed by your responses above (please include comments on the materiality determination process [Section 5B] in your answer to question 11 above rather than here).*

On 5G Reporting boundary and specifically for 5.28 (Financial reporting entity – control and significant influence) the Forum believes that a financial control approach provides the best way to ensure comparability and consistency.

Specifically on carbon-emission reporting, companies have noted that they find it more practical to report emissions for projects where they have operational control . They also state that this ties in with emission-reduction targets which are based on areas where companies have operational control and, as such, reporting should be in line with these targets. As a general rule, the Forum considers that reporting on a financial control basis should be the standard. Companies who wish to include operational-control reporting may do so but financial-control reporting should be the end goal.

LAPFF agrees that financial control should form the minimal reporting boundary, but that when identifying opportunities, risks and outcomes over the longer term, a wider boundary is necessary. Industry labour practices and those of suppliers have been identified as potentially material for value creation (or destruction). LAPFF would concur through its experiences of engaging with companies, particularly those with operations in different national jurisdictions, that such human capital reporting is crucial in identifying both near and long term financial, reputational, political and other risks to companies' long term success (e.g.www.lapfforum.org/TTx2/press/files/national-express-investor-statement).

LAPFF welcomes the recognition given to the rising importance of web-based media and the associated potential to improve stakeholder engagement and provide useful information to companies. This relevance has been cited to the Forum in companies' engagement with the Forum.

Overall view

22. *Recognizing that <IR> will evolve over time, please explain the extent to which you believe the content of the Framework overall is appropriate for use by organizations in preparing an integrated report and for providing report users with information about an organization's ability to create value in the short, medium and long term?*

The content of the framework overall is appropriate for organisations in preparing an integrated report. It should not be any more prescriptive; it already recognises all nationally legislated reporting requirements and its main impetus is to describe a process by which companies can arrive at an integrated and meaningful form of reporting.

Instead, companies working to improve reporting can look to additional guidance provided by the Integrated Reporting Database and publications which recognise and support the initiative (e.g. 'Climate Change: Your journey to Integrated Reporting', Promethium Carbon and CDSB).

Development of <IR>

23. *If the IIRC were to develop explanatory material on <IR> in addition to the Framework, which three topics would you recommend be given priority? Why?*

Comments made in response to question 12 are relevant here and related guidance on the topic of materiality as a separate supplement might be useful.

LAPFF recognises that the framework has developed over a period of consultation and experimentation. One of the more useful guidance documents for investors and companies appears to be the Pilot Programme Yearbook. In particular examples provided by companies such as Microsoft and Marks and Spencer are useful in translating the theoretical framework into practical examples of reporting.

Companies in different sectors will have very different challenges, so LAPFF would not recommend any further topics as a priority, but would recommend that the Yearbook be continued, and that further examples are provided as practical guidance for different companies and sectors on how 'soft-ware' / intangible issues can be measured and usefully reported on, in addition to the more traditionally 'hard-ware' / financial reporting.

Other

24. Please provide any other comments not already addressed by your responses to Questions 1-23.

As investors' portfolios expand globally, development of an international, consistent framework for reporting would appear to be a priority. Whilst there are innovative companies already adopting this framework unless reporting is made mandatory progress is likely to be slow. LAPFF would recommend that pressure is brought to bear on regulators to engage further with the framework with a view to mandating this form of reporting.

In the UK, this should involve a review of the guidance for the strategic report to ensure that all relevant aspects of the integrated reporting model are captured. LAPFF notes in this regard that the FRC's plan for 2013-14 aims to 'develop narrative reporting guidance to support BIS regulations, moving towards a more concise, relevant, and principles-based approach which also takes account of the integrated reporting framework' .