



**CHARTERED SECRETARIES
AUSTRALIA**

Leaders in governance

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International Integrated Reporting Council (IIRC)
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Dear Council members

Consultation Draft of the International <IR> Framework

Chartered Secretaries Australia (CSA) welcomes the opportunity to comment on the *Consultation Draft of the International <IR> Framework* (Draft Framework).

CSA is the peak professional body delivering accredited education and the most practical and authoritative training and information in governance and risk management in Australia. Our Members are all involved in governance and corporate reporting, with primary responsibility to develop and implement governance frameworks in public listed and public unlisted companies, as well as in private companies, not-for-profit organisations and in the public sector.

We remain strong supporters of the aims of integrated reporting. If the objectives of holistic, concise and meaningful reporting can be achieved, we are of the view that integrated reporting can demonstrate the stewardship capacities of an entity and how it creates and sustains value over time. We also commend the Council for being so receptive to feedback from stakeholders — we can see that the Draft Framework is different from the Prototype Framework and has taken account of input from those participating in consultations.

Our comments on the Draft Framework are offered with a view to ensuring that the final framework encourages entities to move to integrated reporting and alleviates concerns that 'yet another report' will be imposed on organisations already burdened by a plethora of disclosure obligations, some — but not all — of which provide value to stakeholders.

Key points

Reporting in accordance with the Framework

A key concern with the Draft Framework is the requirement that an entity must report against all six capitals, regardless of whether they are relevant. This appears to impose a 'brand' on reporting, which we believe will undermine the willingness of entities to embark on the journey and explore how they can move to integrated thinking and integrated reporting. CSA believes that entities should be encouraged to approach integrated reporting with innovation and pragmatism, and that this will not occur if there is a requirement for strict adherence to the 'capitals'.

CSA notes that the Draft Framework does contain one paragraph (2.18 on p 13) that states that all six capitals may not be equally relevant or applicable to an entity, and that the interactions of all capitals may be immaterial for integrated reporting purposes. However, this message is inconsistent with earlier sections of the Draft Framework that requires entities to identify in bold and italics how they address each capital.

Moreover, the insistence in the Draft Framework on reporting against all six capitals does not accord with discussions held between CSA and Professor Mervyn King, Chair of the Council, and Paul Druckmann, Executive Director of the Council. In those discussions, there was a recognition that the entity needs to decide for itself what is material and what is not material, and that all six capitals may not be applicable. Indeed, CSA produced its first integrated report in March this year, and we did not report against all six capitals. As a not-for-profit organisation and a charity, CSA needs to report to its Members as to whether we are:

- fulfilling our mission of the promotion and advancement of the effective governance and administration of organisations in the private and public sectors through the continued development and application of high level governance skills, knowledge and research and administrative best practice, and
- providing a public good in fulfilment of that mission.

We do this primarily through the provision of education, training and intellectual property — we supply much of the latter free of charge. Neither manufactured capital nor natural capital are material to CSA and we did not report on either of these capitals. Both Professor King and Paul Druckmann agreed that our approach was true to the spirit of integrated reporting.

However, despite our enthusiasm for integrated reporting, and our efforts to embark on the process of developing integrated thinking and report to our Members from that perspective, our first integrated report is not in accordance with the Draft Framework. That is, CSA's report does not 'fit' the brand. We had our first integrated report reviewed by an external firm that is itself a strong proponent of integrated reporting and that review 'marked us down' for not reporting on all six capitals, despite our report clarifying that not all were relevant to CSA. While the purpose of the review was to reveal where we could improve next year — and it was helpful in this regard — the review's insistence on the need for our second integrated report to 'fit' a particular model was not useful.

CSA Members would be very concerned if the final framework discourages entities from moving towards integrated reporting by insisting that they all 'fit' the model. Currently, the Draft Framework is insistent on this point. In particular, paragraph 1.4 on p 8 states that 'An integrated report should be prepared in accordance with this Framework'.

We understand that a key aim of integrated reporting is to provide comparability, but we believe that this can be achieved without imposing a 'one-size-fits-all' approach. The Draft Framework does not sufficiently encourage entities to think long and hard about their own business and report to stakeholders in a desegregated manner so that their stakeholders can understand how the interrelationship of all the business's functions and actions informs decisions concerning prospects, risks and opportunities. Nor does the Draft Framework recognise that each individual reporting entity is unique and that a 'one-size-fits-all' approach is inappropriate.

CSA strongly recommends that the final framework recognise and clarify that:

- the aim of integrated reporting is to provide the board with the tools to desegregate the silos in the business so that directors develop a holistic understanding of the value drivers of the business and that this is the basis of informed reporting to external stakeholders
- the collective mind of the board should be turned to what is material to the business and its economic sustainability, and
- ultimately better business decisions will be made as a result of an enhanced understanding of the business.

and

we also recommend that the final framework encourages the uptake of integrated reporting by clarifying that:

- integrated reporting is about integrated thinking — the report is an outcome of that process rather than the process itself. If the emphasis is on a 'brand' report which does not allow for the unique circumstances of each reporting entity, then issuers will see it as yet another report and not move towards integrated reporting

- companies can start small and expand as they build the capacity for integrated thinking and the metrics for integrated reporting. This is particularly relevant in Australia, where many listed entities do not currently issue a sustainability report — to move to the GRI reporting framework, with its multiple KPIs, would be a massive imposition on many companies. However, if the final framework encourages companies to ‘start somewhere’, they can ‘leapfrog’ sustainability reporting and move straight to integrated reporting, even though they may not have yet developed a full capacity to measure various capitals but are willing to embark on the process of such development
- in a similar fashion, companies with multiple business models, for example, conglomerates, might choose to start with an integrated report on one business rather than the group, or do an integrated report on each business with an additional layer providing a synergistic explanation of how they fit together, as it builds capacity to integrated thinking — again, the emphasis should be on encouraging the move to integrated thinking rather than an insistence on one approach.

Director liability

Financial information is backward-looking and static. Much of the reporting contemplated in the Draft Framework is forward-looking, and therefore constantly changing. As both Professor King and Paul Druckmann are aware, following their visit to Australia, there is considerable concern in this jurisdiction that our current business judgement rule is too narrow to facilitate directors making forward-looking statements.

If directors are releasing prospective information, issues of personal liability arise. Directors are subject to statutory and common law duties which require them to act with reasonable care and diligence, in good faith in the best interests of the company and for a proper purpose. A defence may apply to decisions taken by directors in relation to breaches of care and diligence but it is not available, at least in Australia, where the process leading up to the decision is defective (such as where the decision is made on the basis of clearly inadequate information or it is not reasonable to rely on the advice of those providing the information). Providing forward-looking reporting means that the information provided could well be based on inadequate information, given that circumstances can change rapidly. This exposes directors to much higher risks of actions against them, including class actions, which are becoming increasingly prevalent and remain only lightly regulated. At present, an adequate ‘safe harbour’ from liability for directors and executives for making forward-looking statements has not been adopted in Australia, although CSA notes it has in other jurisdictions such as the UK. CSA and other parties are advocating that such a ‘safe harbour’ be introduced in Australia, on the basis that the uptake of integrated reporting and the call for increasingly detailed forward-looking statements in ASIC’s Regulatory Guide 247 on the operating and financial review (OFR) will be hindered if this liability issue is not addressed.

On a different front, CSA is pleased to see that the Draft Framework is explicit in paragraph 5.17 on p 32 that those charged with governance are responsible for ensuring there is effective leadership and decision-making regarding integrated reporting. However, paragraph 5.18 states that the governing body ‘may’ include a statement in the integrated report regarding:

- ‘An acknowledgement of its responsibility to ensure the integrity of the integrated report
- that it has applied its collective mind to the preparation of the integrated report and the information it contains
- its opinion or conclusion about whether the report is presented in accordance with the Framework’.

CSA is of the view that such a statement should not be optional and **CSA recommends** that the final framework use the word ‘will’ rather than ‘may’. It is important that all parties collaborate, but integrated reporting is not a process that can be delegated to management and it will require ongoing commitment from the board of directors itself.

CSA reiterates, however, that it is important that any opinion or conclusion drawn by the board of directors about whether the report is presented in accordance with the framework also be

considered in light of our earlier comments about the applicability of the various capitals to the unique circumstances of each reporting entity.

Our comments on the 'Consultation Questions' follow.

Application of the Framework

In paragraph 1.12 on p 8, the Draft Framework requires entities to report on information that has been omitted and explain why the information has not been disclosed. CSA strongly opposes including this requirement in the final framework.

The Australian Securities and Investments Commission (ASIC) consulted in 2012 on its draft Regulatory Guide on the Operating and Financial Review (OFR), which deals with the commentary required to be given to investors in the directors' Report under s299A of the Corporations Act.

In the Regulatory Guide, there is a carve out from disclosure if the publication of information would result in unreasonable prejudice.

During the consultation ASIC accepted the feedback from stakeholders that its initial proposal to require disclosure of a summary of omitted information and the reasons for omitting the information defeated the purpose of the exemptions. That is, Australia's corporate regulator accepted that reporting on omitted information is nonsensical, and there is no such requirement in ASIC's final *Regulatory Guide 247: Effective disclosure in an operating and financial review*, which was issued in March 2013.

A useful approach to this exemption is to identify the adverse consequences likely to occur (that is, the prejudice), and then consider whether these consequences are unreasonable. The consequences would be unreasonable if disclosing the information is likely to give third parties (such as competitors, suppliers and buyers) a commercial advantage, resulting in a material disadvantage to the entity.

If the information is omitted in reliance on the exemption (for the reasons set out above), the current requirement in the Draft Framework that the omitted information must be disclosed as well as an explanation of why it has not been disclosed will result in the reporting of the very information that the entity wished to maintain as confidential. That is, the Draft Framework would require disclosure of information to third parties that is likely to give such parties a commercial advantage, resulting in a material disadvantage to the entity.

CSA is of the view that this requirement in the Draft Framework defeats the purpose of why some information is omitted in the first place. Providing reasons for the exemption simply exacerbates the problem, as the reasons clarify why the information is commercially sensitive and therefore of value to competitors and other third parties. CSA cannot see any benefit to investors in providing such disclosures and reasons. Alternatively, if the disclosure of the omitted information is so 'high level' that confidentiality is protected, it serves no useful purpose and becomes mere 'boilerplate' disclosure.

Furthermore, CSA notes that the Draft Framework is clear that only material information should be disclosed (unless publication of this information would result in unreasonable prejudice). Requiring an entity to disclose all the information it has omitted because it has decided it is not material is counter-productive to the aims of conciseness and materiality.

CSA recommends that this requirement be omitted in the final framework.

Audience

The Draft Framework is clear that, ultimately, the report is aimed at providing clarity to the providers of financial capital, but that any report should recognise that it will be useful to a broader audience.

CSA recommends that the final framework clarify that the providers of financial capital are investors, and not debt providers.

Principles-based requirements

CSA recognises that the Draft Framework seeks to be principles-based in its approach, but as noted above there is a prescriptive element to it. In particular, paragraph 1.4 on p 8 states that 'An integrated report should be prepared in accordance with this Framework'. CSA is strongly of the view that this will discourage many entities from embarking on integrated reporting, as they will not be in a position to 'fit' the model. CSA reiterates that entities are unlikely to approach integrated reporting with innovation and pragmatism if there is a requirement for strict adherence to the capitals.

For example, as noted above, many listed entities in Australia do not currently issue a sustainability report. They have not developed the internal processes for capturing all relevant data nor have they developed the capacity to measure various sustainability-related functions and activities. CSA has detected considerable interest and enthusiasm among Australian listed entities to explore integrated reporting, but in a great majority of instances the companies are not in a position to prepare a report in accordance with the Draft Framework. That is, issuers may be keen to adopt integrated thinking and want to develop the capacity to build metrics in relation to many of the six capitals. The final framework should support this enthusiasm by encouraging reporting entities to prepare an integrated report that is consistent with the principles set out in the framework without demanding slavish adherence to a 'one-size-fits-all' approach.

Interaction with other reports and communications

CSA is of the view that the Draft Framework struggles to deal with how the report can integrate with all communications to shareholders and other stakeholders. We also believe that this is because of the insistence on the imposition of a 'brand'. As a result the Draft Framework is focussed on the outcome rather than the process; one report rather than on how integrated thinking can assist entities to desegregate the business and communicate a holistic view of the value drivers of the business across all communications with shareholders.

The capitals

As noted above, the Draft Framework's insistence that an integrated report must make disclosures against all six capitals, regardless of whether they are relevant or applicable to the entity, will undermine the willingness of entities to embark on the journey and explore how they can move to integrated thinking and integrated reporting.

On the definition of human capital, CSA disagrees with the statement on p 12 that defines it as 'People's competencies, capabilities and experience, and their motivations to innovate ...'. While an entity can report on its capacity to innovate in terms of processes, systems and resources, it cannot report on people's loyalties and motivations, which are personal to individuals. Entities can report that they have put in place the framework and resources to facilitate innovation, but individuals will choose whether they will innovate or not, and an entity cannot report on their motivations for that choice.

Business model

We appreciate that the Draft Framework clarifies that the company reports on the corporate group and not on individual businesses inside the group. This is helpful to large corporate groups. However, where an entity has multiple business models (as is the case for conglomerates), it is not straightforward. CSA notes that the framework does not easily lend itself to corporate groups which have many discreet businesses within their portfolio.

CSA recommends, therefore, that the final framework encourage entities with multiple business models to consider undertaking a report on one business rather than the group, or preparing an integrated report on each business with an additional layer providing a synergistic explanation of how they fit together as a first step to embarking on the integrated reporting journey.

Value creation

As noted above, the Draft Framework is clear that, ultimately, the report is aimed at providing clarity to investors of value creation over time. However, the Draft Framework also addresses environmental sustainability, where investors are often most interested in understanding the economic sustainability of a company. Investors want to know what the risks are of allocating capital to a company and whether the company understands its environmental impact. This is a different matter from sustainable development, which refers to a mode of human development in which resource use aims to meet human needs while ensuring the sustainability of natural systems and the environment, so that these needs can be met not only in the present, but also for generations to come.

While the definition of sustainable development as set out above can clearly inform a board's thinking on the economic sustainability of the entity, these two concepts are distinct and should not be blurred. This in turn highlights that the final framework needs to contain greater clarity about how a company can deal with the trade-offs of economic sustainability and environmental impact. The company can report on what the company does, how it does it and why it does it, but it is for the investor to decide the trade-offs.

Materiality

The guidance issued by the Council on materiality is ambiguous and could be misinterpreted. CSA has strong concerns with this guidance, which risks making such a key concept distinctly unclear and also risks placing listed entities in Australia in conflict with their regulatory obligations. Moreover, if the aim of integrated reporting is to provide comparability for users, this guidance will not assist in this regard, due to its lack of clarity.

Certainly within Australia, listed entities have both a regulatory obligation and the capacity to judge materiality. Those working in governance in Australian listed entities are judging materiality on a day-by-day basis under the continuous disclosure regime, which requires listed public companies and disclosing entities to disclose materially price-sensitive information immediately upon becoming aware of it. Earlier this year, after extensive consultation, the Australian Securities Exchange (ASX) issued the revised Guidance Note 8 on continuous disclosure. Guidance Note 8 provides excellent guidance on materiality.

Likewise, there is a firm frame of reference for materiality in the accounting standards for the preparation of financial reports.

CSA recommends that the final framework link to the applicable regulatory framework in different jurisdictions. There is considerable overlap between the aspects of the Draft Framework with ASIC's Regulatory Guide on the OFR. In Australia, all listed companies have a statutory obligation to issue an OFR, and the statutory obligation will always have precedence in reporting. The final framework needs to recognise that there will be different regulatory obligations in place, some of which deal with similar territory to that covered in the framework for integrated reporting, and confirm that any regulatory obligation has precedence over the framework.

Overall view and development of <IR>

The Draft Framework is aspirational in that it sets out a scheme for a 'process that results in communication by an organisation, most visibly a periodic integrated report about value creation over time' (paragraph 1.2 on p 8).

That is, the framework is intended to assist organisations to undertake integrated thinking, allowing them to undertake a change management program so that they can:

- break down the propensity to thinking and operating in 'silos' that occurs in many organisations approach
- the business in a desegregated manner in order to understand how the interrelationship of all its functions and actions can inform decisions concerning prospects, risks and opportunities
- make better business decisions as a result of an enhanced understanding of the business.

The integrated report is the outcome of this process.

While CSA Members believe that undertaking such a change management process will lead to a better understanding of a business, and better decision-making for a business, we note that the reality is that:

- many organisations currently operate in silos
- there will often be few individuals within an organisation with the breadth of knowledge to synthesise information from various silos. Within corporate groups the CEOs of individual businesses know the value drivers of their business, but not necessarily those of the group
- not all organisations will have the resources to form an Integrated Reporting Steering Committee to bring together different parts of the business to synthesise information.

CSA is concerned, therefore, that it can be difficult for organisations, and the individuals within those organisations who would like to champion integrated reporting, to know how to progress to an integrated report. Reading the Draft Framework can be daunting for individuals faced with the reality of an organisation's current approach, yet the Draft Framework itself does not supply any guidance on how an organisation might embark on such a change management process. It can be even more daunting when the planning and progress of an annual report is the Key Performance Indicator (KPI) for one individual who must undertake their normal daily responsibilities while seeking to usher in a change management process. Those interested in moving towards integrated reporting will be looking for some guidance on 'how' an organisation might undertake that process. This is not assisted by the imposition of a 'brand' of reporting, as noted earlier.

While we accept that there are other resources available to consult, such as the examples from the Pilot Programme, and various publications issued by participating Council members, CSA nonetheless notes that the final framework would be assisted if it clarified that integrated thinking cannot be achieved quickly and an integrated report will be a work in progress. Indeed, CSA strongly recommends that the final framework:

- include guidance that an organisation can take some steps in its first year, and further steps in the second and third years, progressing toward a more sophisticated integrated report over time
- encourage organisations to move to integrated thinking as the key step in the process, rather than concentrating solely on the integrated report as the outcome of that process

Providing guidance that an acceptable approach to commencing this change management process is to 'bite off what you can chew' would alleviate anxiety and encourage greater levels of participation. It would also counter the suspicion that an integrated report is 'just one more report', which is heightened by the focus in the Draft Framework on reporting according to the framework.

The guidance might provide organisations with a choice of consolidating their existing reports as a first step in integrated thinking processes — while this is not integration, it can allow for improvements in the reporting of financial information, sustainability and management commentary. Conciseness can be encouraged in the consolidation. This has occurred in practice, and so is a reasonable first step for those new to this journey.

The guidance could also suggest that, where no sustainability report exists, an organisation could choose to undertake integrated thinking to begin to build capacity for measuring the material significance of environmental and social risks and 'leapfrog' sustainability reporting. CSA notes that the Australian Council of Superannuation Investors' research on sustainability reporting practices of the S&P/ASX 200 over six years show that there is a very slow trend towards improved sustainability reporting in Australia, with 45 per cent of the ASX200 continuing to provide average to poor sustainability reporting.¹ Rather than entities believing they must move first to sustainability reporting and the full GRI data set, which can be extremely daunting for those that have not undertaken this process previously, it would be a significant improvement for many Australian listed companies if they began to think about their businesses in a desegregated fashion and began to develop capacity to build sustainability metrics as part of that process.

The guidance could note that a second stage could be to use management commentary to refocus business reporting around the organisation's business model and operational priorities. This is the beginning of an organisation 'telling its story', as it reports on the context in which the business operates and its strategy to address the opportunities and challenges it faces.

A third stage could be to report on the current shape and performance of the business, the likely effect of management's plans, external opportunities and other issues affecting the business, and also the 'game-changing' opportunities and risks. Incorporating forward-looking, strategic KPIs provides for reporting on the business year-to-year, so that investors can assess how the business is performing over the medium to long term.

The guidance would therefore clarify that there is an evolution to the integration of critical business performance information, traditional financial reporting, management commentary and sustainability reporting to allow external analysts, investors and others to make informed judgements about the entity's long term prospects.

CSA is of the view that guidance of this kind would encourage a great many entities to embark on integrated reporting. The Council will review its final framework in light of practice over the next few years, and is likely to revise, update and reissue it. If the guidance we are suggesting is no longer considered necessary at that time, it can be deleted. However, CSA is of the view that it would greatly facilitate the uptake of integrated reporting at this early stage.

Conclusion

CSA Members recognise that there is a range of issues and opportunities affecting long-term business value that is much broader than can be reflected in a set of current-year financial measures. CSA Members seek to provide reporting that provides a more comprehensive perspective on business performance and value and commends the Council on releasing the Draft Framework as a great step forward.

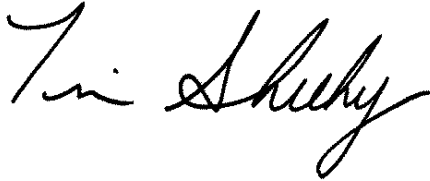
We believe that the uptake of integrated reporting will be facilitated if the final framework clarifies that:

- there is no 'one-size-fits-all' approach — in the beginning stages entities will report against some capitals but may be building capacity in other areas, and not all capitals will be relevant and applicable to all organisations
- there is a process of change in reporting that will arise as entities embark on integrated thinking, and those wishing to embark on integrated reporting should 'wade in and have a go' but not feel that they must stringently fit the final framework in one single step.

¹ Australian Council of Superannuation Investors, *Sustainability Reporting Practices of the S&P/ASX200, As at March 2013, Research Paper*

CSA Members look forward to the release of the final framework later this year.

Yours sincerely

A handwritten signature in black ink, reading "Tim Sheehy". The signature is written in a cursive, flowing style with a large initial "T" and a long, sweeping underline.

Tim Sheehy
CHIEF EXECUTIVE