



PITCHER PARTNERS
ACCOUNTANTS • AUDITORS • ADVISORS

Level 19
15 William Street
Melbourne
Victoria 3000

Postal Address:
GPO Box 5193
Melbourne Vic 3001
Australia

Level 1
80 Monash Drive
Dandenong South
Victoria 3175

Tel: 03 8610 5000
Fax: 03 8610 5999
partners@pitcher.com.au
www.pitcher.com.au

J BRAZZALE
I D STEWART
M W PRINGLE
D A THOMSON
M J LANGHAMMER
S SCHONBERG
M D NORTHEAST
P A JOSE
M J HARRISON
T SAKELL
G I NORISKIN
B J BRITTEN
K L BYRNE
S D WHITCHURCH
D J HONEY
G J NIELSEN
N R BULL
A M KOKKINOS
G A DEBONO
R H SHRAPNEL
F V RUSSO
M R SONEGO

D B RANKIN
A R FITZPATRICK
R RIGONI
G M RAMBALDI
D A KNOWLES
M C HAY
V A MACDERMID
S DAHN
A R YEO
P W TONER
D R VASUDEVAN
S D AZOOR HUGHES
A T DAVIDSON
C D WHATMAN
A E CLERICI
P MURONE
A D STANLEY
D C BYRNE
P B BRAINE
R I MCKIE
T G HAIR

Ref: DAH

15 July 2013

Mr Mervyn King
Chairman
International Integrated Reporting Council
Via website: www.theiirc.org

Dear Mr King

CONSULTATION DRAFT OF THE INTERNATIONAL <IR> FRAMEWORK

Thank you for the opportunity to comment on the Consultation Draft.

Pitcher Partners is an association of independent firms operating from all major cities in Australia. Our clients come from a wide range of industries and include listed and non-listed disclosing entities, large private businesses, family groups, government entities and small to medium sized enterprises, including not-for-profit entities.

The <IR> Framework provides an opportunity for businesses to report on value creation, beyond financial measures. Although not targeted at these segments, the <IR> Framework has the potential to provide a more robust reporting framework for those entities that are not focussed on short-term financial results.

Overall, the IIRC needs to further develop the reporting criteria for each category of capital by reference to associated value drivers. As the cost to produce an integrated report is likely to be prohibitive, it would be preferable for the IIRC to streamline principles and objectives relating to each category of capital and recognise that in many jurisdictions, certain objectives will be mandated through laws and regulation. These factors are described in more detail in our responses to the consultation questions as attached.

Please do not hesitate to contact me if there are any matters arising, which require further clarification.

Yours sincerely

S DIANNE AZOOR HUGHES
Partner

Consultation questions

Chapter 1: Overview

Q1: Should any additional principle-based requirements be added or should any be eliminated or changed? If so, please explain why.

Paragraph 1.6 identifies the primary “Audience for <IR>” as the providers of financial capital with the purpose of <IR> being to support their financial capital allocation assessments. Context and perspective are critical to the implementation of the <IR> Framework and therefore paragraph 1.6 is critical to how the Framework might be used in practice. Paragraph 1.7 notes that all stakeholders are interested in an organization’s ability to create value over time. However “value” can have a very different meaning depending on perspective.

For example: consider the recent fire and building collapse in a garment factory in Bangladesh. I visited Dhaka in 2012 and I have seen for myself the conditions under which people live and work. Nonetheless, sourcing garments from Bangladesh, albeit from facilities that were not subject to minimum safety standards, certainly create *financial* value for employees, customers, suppliers, business partners and local communities.

While there is general agreement with the principle-based requirements, the moral and ethical substance which, in my view, should support business decisions, has not been adequately contemplated. Although a difficult area in which to set standards, given the increasing awareness and support of ethical investments, I consider that the <IR> Framework should be a tool for balancing social/environmental/corporate responsibility with financial returns.

Q2: Do you agree with how paragraphs 1.18-1.20 characterize the interaction with other reports and communications?

Integrated thinking is essential for sound long-term decision-making and the discussion in paragraphs 1.15-1.17 is supported. However, in paragraphs 1.18-1.20, the fact that different reports may have conflicting objectives has not been recognised or addressed. For example, financial reports prepared in accordance with IFRS reflect changes in value pursuant to *current* conditions (refer IFRS 13 Fair Value Measurement which requires fair value measurements to reflect orderly transactions between market participants under current market conditions). Market participants may or may not concur with whether long term strategic goals are achievable.

The last sentence of paragraph 1.20 states: “In particular, it has a combined emphasis on: conciseness, strategic focus and future orientation, the connectivity of information, the capitals, the business model, the ability to create value in the short, medium and long term and providers of financial capital as the primary audience.” Given the extensive information provided in financial reports alone, and the need to reconcile the various responsibilities (and reported amounts) associated with sustaining the different forms of capital, the sentence is at best, idealistic.

In my view, it would be preferable for the <IR> Framework to provide an opportunity to explain to a provider of financial capital, how differing objectives and motivations have been balanced to achieve strategic goals. The integrated thinker and the integrated-thinking-investor are unlikely to have the same perspective as the so-called *economically rational investor* who makes decisions to maximise financial returns in the short-term.

Q3: No comment

Q4: No further comments.

Chapter 2: Fundamental concepts

The capitals (Section 2B)

Q5: *Do you agree with this approach to capitals? Why/why not?*

Generally agreed

Q6: *Please provide any other comments you have about Section 2B*

The terms “manufactured capital” and “natural capital” are not intuitive. Although not critical, terms such as “physical capital” and “environmental capital” would be easier to understand. In particular the term “manufactured capital” is spurious – manufactured by whom? Is a purchased object included as “manufactured capital”? In what circumstances are purchased objects included or excluded? What about useful lives? Is there a minimum useful life? Etc.

Business model (Section 2C)

Q7-Q9

In general the definitions and discussions are considered appropriate.

However, relatively few businesses document or explain their business model in such a comprehensive way. Further, many businesses need to allow a certain amount of flexibility in their business plans to accommodate and respond to changing business conditions. This is particular necessary when a business is *not* a market leader.

Consequently, while the discussion is useful and appropriate to assist entities to develop more comprehensive business models, the cost may well outweigh the benefits in the short term. It would be preferable to include discussion addressing how business models might change or evolve over time. As written there is a sense that the business model establishes the nature and scope of activity, which may be true for the world’s largest businesses. However, for a majority of smaller listed entities the (documented) business model may establish little more than terms of reference.

Other

Q10: *Any other comments*

The discussion in paragraph 2.45 is critical to integrated thinking and integrated reporting. It would be preferable to expand this section to provide more examples of (non-financial) value drivers.

Chapter 3: Guiding Principles

Materiality and conciseness (Section 3D)

Q11: *Do you agree with this approach materiality?*

Q12: *Any other comments*

Materiality for financial reporting purposes considers both the nature and the magnitude of an item, and the assessment of materiality is made within the context of the financial reporting framework. However, even within this relatively narrow scope for financial reporting purposes, determination of whether or not an item is material is not a straightforward process.

In respect of the <IR> Framework, materiality is considered in the context of the organization’s ability to *create value* over the short, medium and long term from the perspective of the primary intended users (paragraph 3.23) i.e. the providers of financial

capital. If the meaning attributed to *value* is limited to *financial value* then materiality will be aligned with financial reporting materiality. However, if the *value* that flows from integrated thinking is broader than financial outcomes, then the concept of materiality needs further discussion in this framework.

For example, if a business sources supplies from a garment factory in Bangladesh, which does not meet minimum safety standards, how will materiality be determined beyond any financial impact? Should materiality be determined beyond financial impact?

Relating this scenario back to paragraph 2.45 which describes examples of value drivers, in my opinion the scenario above would be material to brand equity, customer relations, responses to societal expectations and values such as integrity and trust. The discussion in this section should describe how materiality is assessed in response to these non-financial drivers. For example, the entity may have a code of ethics or terms of trade, which can be used as a benchmark to determine materiality in respect of these issues for an individual business.

The materiality determination process in Section 5B is a reasonable starting point. Paragraph 5.5 includes the statement: "Matters are not excluded on the basis that the organization does not wish to address them or does not know how to deal with them." However, in the absence of explicit principles regarding materiality for each category of capital, matters to be included or excluded have no boundaries.

As discussed in Section 5B and 5C judgment is needed to identify and describe material matters in the reporting process. It would be preferable to identify high-level objectives in respect of each category of capital, which might then be prioritised by individual companies and supported by more detailed internally developed policies, against which materiality determinations can be made.

For example: (from paragraph 2.17)

Social and relationship capital – shared norms, and common values and behaviours

Principles to include in the framework might include: working conditions; pay rates; anti-discrimination policies

Internal policies might include:

- The entity will provide a safe working environment for all employees.
- The entity will pay employees at or above the minimum wage rates in all jurisdictions in which it operates.
- The entity is an equal opportunity employer and will recruit people according to their skill, experience and abilities without regard to sex, race, colour, marital status, age, disability, physical features, religious or political beliefs, industrial activity, gender identity, sexual orientation, pregnancy or breastfeeding.

Materiality considerations would then be assessed by reference to the internal policies, which in turn should prompt disclosure of to what extent identified objectives had been achieved or required attention.

Reliability and completeness (Section 3E)

Q13: How should the reliability of an integrated report be demonstrated?

Q14: Any other comments

This section provides a fair appraisal of issues to be considered. However, many of the thoughts presented here are derived from consideration of *value* and *materiality* as described in earlier sections. Consequently, without any parameters to understand *value* beyond *financial values*, or materiality beyond *financial materiality* considerations, an assessment of *completeness* cannot have a consistent meaning.

In my opinion, high level principles should be described for each classification of capital so that an entity can identify which principles are important to the value drivers of the business. Internal policies and materiality can then also be clearly aligned with those value drivers that are important to the business.

If the focus of <IR> is on the creation of value and value drivers, then analysing the sufficiency of existing systems should always highlight areas where better systems are needed to manage the business, rather than for reporting purposes alone (as stated paragraph 3.41). This evaluation should be a value-adding process for the business and particularly where non-financial value drivers had not previously received due recognition.

As discussed in paragraphs 3.42 to 3.47, a serious impediment to <IR> is the potential impact on competitive advantage through disclosure of value drivers, and through the disclosure of future-oriented information. In markets such as Australia, where there are a limited number of dominant players in any industry, these issues are particularly sensitive to smaller market participants. Also, disclosure of future-oriented information has implications for director liability where future events do not unwind as anticipated.

Other

Q15: No further comments

Chapter 4: Content Elements

Q16: Any other comments

As described in paragraph 4.8, factors affecting the external environment include aspects of the legal, commercial, social, environmental and political context that affect the organization's ability to create value. Consequently, the 'benchmark' for acceptable corporate behaviours or corporate responses might vary significantly from one jurisdiction to another.

Using the example under Q11 and Q12 above, regarding aspects of *social and relational capital*, some jurisdictions will have strong legislation governing working conditions; pay rates; anti-discrimination policies and established case law governing workplace practices. Other jurisdictions may not have any legislation, or minimal legislative requirements and a weak legislative enforcement system. Irrespective of external requirements, it would be preferable for the <IR> Framework to explicitly state the high-level principles (such as working conditions; pay rates; anti-discrimination policies etc.) so that the <IR> could then disclose to what extent these issues were relevant for the creation of value. Explicit articulation of a range of high level principles applicable to each category of capital would enable better comparability and consistency in presentation, albeit that the way in which such items were implemented would vary from one entity to another.

Chapter 5: Preparation and presentation

Section 5D

Q17: Should there be a requirement for those charged with governance to include a statement acknowledging their responsibility for the integrated report? Why/why not?

As described in paragraphs 5.17 and 5.18, those charged with governance have responsibility for how the organization's strategy, governance, performance and prospects lead to value creation over time. Consequently, it is entirely appropriate that those charged with governance acknowledge their responsibility for the integrated report.

In particular, those charged with governance should take responsibility for agreeing the scope of the integrated report and the determination of materiality from the perspective of the organization as a whole responding to stakeholder needs. Management often only has responsibility for particular aspects of the organization, and therefore the reporting responsibilities for the organization as a whole should be assigned to those who have responsibility for the organization as a whole i.e. those charged with governance.

Credibility (Section 5E)

Q19: If assurance is to be obtained, should it cover the integrated report as a whole, or specific aspects of the report? Why?

Q20: Any other comments

A critical element of an assurance engagement is having suitable criteria to evaluate preparation and presentation of the subject matter. Although the <IR> Framework provides criteria to some extent, in some areas (determination of *value* and *materiality* in particular (refer discussion above)) the criteria is not sufficiently robust. In the absence of principles or objectives to provide guidance for matters to be considered in respect of the value drivers relevant to each category of capital, assurance in respect of *completeness* of the integrated report would appear to be practically impossible.

- The <IR> Framework identifies six categories of capital. It needs to provide (perhaps minimal high-level) principles or objectives relating to each of these types of capital.
- An entity would then identify the value drivers relevant to the business, which might include some or all of the categories of capital.
- The integrated report would disclose information relating to those principles/objectives addressed by the business that support the value drivers.
- Materiality would be considered by reference to categories of capital and the principles/objectives that were or were not included in the integrated report. In some situations explanation of "if not why not" might also be appropriate.

Other

Q21: No further comments

Overall view

Q22

The <IR> Framework provides a good roadmap in terms of describing the issues that are relevant to preparing an integrated report. However, the criteria are not yet sufficiently robust to promote comparability or consistency in the preparation of integrated reports and users are likely to have difficulty in evaluating the quality and completeness of the information provided.

Another major obstacle that businesses must overcome is identifying how integrated reports should be presented to facilitate both understandability and useability. For example, stakeholders do not need another 50-100 page hard copy document that follows a sequential format. Presentation of the integrated report in a digital format - for example in a web page, which includes a search function and enables both hyperlinking and drilling down through high level information to detail (where appropriate), would greatly improve the usefulness of the information provided.

Development of <IR>

Q23: If the IIRC were to develop explanatory material on <IR> in addition to the Framework, which three topics would you recommend to be given priority? Why?

The three topics would be:

- Principles and objectives relevant to an evaluation of each category of capital – as explained above, this would establish more robust criteria to promote consistency and comparability of reports
- Identifying the value drivers relevant to the organization and their *capital* base – as explained above, this would establish the scope of the integrated report presented
- Assessing completeness of information contained in an integrated report – this aspect links the two points above and is critical to ensuring that integrated reports are not used to showcase good behaviours and omit less favourable findings.

Other

Q24: Any other comments

Articulation of Mission and Vision

A key omission in the <IR> Framework is a reference to the entity's mission statement and its vision statement. Given that the <IR> Framework is concerned with the creation of value and short, medium and long term goals, articulation of mission (being the entity's purpose and primary objectives) and the articulation of vision (stating what the entity wants to achieve in the future) provides the 'goalposts' for stakeholders to understand the information provided.

Not-for-profit organisations

The Australian Charities and Not-for-profit Commission (ACNC) has introduced new governance standards and reporting requirements for registered charities in Australia. Although these requirements have not been labelled as an integrated report, many aspects of the <IR> Framework are effectively included. In particular, there is a focus on the purpose and objectives of such organisations, and disclosure relating to non-financial performance goals. Consequently, the <IR> Framework could be tailored to address the reporting needs of

different types of entities, simply by the identification of different principles/objectives relevant to the different categories of capital.

Private business reporting

Privately owned business often has a more holistic approach to governance, rather than a focus on the need to report short-term financial gains to investors in capital markets. Many decisions are made with long-term objectives in mind, which might seem less than optimal to a so called 'rational investor' looking for short-term economic gains. Although much of the information that might be disclosed in an integrated report for a privately owned business would be competitively sensitive, the <IR> Framework provides a more holistic roadmap for explaining strategy implementation to finance providers and like-minded private investors or family members. Consequently it would be preferable for the IIRC to keep in mind the scale-ability and the broader use that this framework might have beyond public reporting.

Cost/benefit

For many entities the cost to produce this report is likely to be prohibitive, and particularly in a post-GFC era when costs are being closely monitored. However, many aspects of the <IR> Framework are being introduced in Australia through other legislation. For example, environmental issues are captured through environmental laws and regulations, greenhouse gas reporting and the cost of using water. Similar, occupational health and safety issues, minimum pay awards and various training incentives promote good governance in respect of employee working conditions. Although not optimal, it might be possible to develop an <IR> matrix that demonstrated to what extent the different categories of capital were regulated in the environment(s) in which a business operated.