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AAT RESPONSE TO CONSULTATION DRAFT OF THE INTERNATIONAL FRAMEWORK ON INTEGRATED REPORTING

1 INTRODUCTION

1.1 AAT is pleased to comment on the Response to the Consultation Draft of the International Framework on Integrated Reporting issued by the International Integrated Reporting Council in April 2013. AAT is a registered charity one of whose object clauses is to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

1.2 AAT is a global organisation and enjoys a total membership in excess of 121,800[1] worldwide, which is made up of 50,300[1] full and fellow members. The balance consists of student and affiliate members.

1.3 Of the full and fellow members there are approximately 3,800[1] Members in Practice providing accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types. Whilst members permeate all levels and sectors of the market they are most active in the Small and Medium Sized Entity market.

2 GENERAL COMMENTS

2.1 We support the concept of introducing a Standard for the preparation of Integrated Reports ("IR"). However, we are concerned that the proposed Framework will create irreconcilable conflicts of interest between the management of an organisation and its other stakeholders which would negate any of the parties involved achieving the intended benefits of an IR. The consequences of an organisation having to make Integrated Reports available to all of its stakeholders are such that the organisation may suffer from the contents of the IR being publicly available and used by third parties to the disadvantage of the entity, or the usefulness of the contents of the IR will be compromised by the need for heavy editing.

2.2 The proposed contents of an IR are all potentially sensitive matters which if published could prejudice the operations of an organisation. Those organisations with the strongest governance, opportunities, strategies, resources, business model and performance will be happy to report such but most organisations have weaknesses in some areas and will naturally be reluctant to report fully and so deprive stakeholders of information important to them.

2.3 Most organisations have to make management decisions based on compromise because of the interaction of capitals and it is the basis of these

[1] Figures correct as at 31 March 2013

compromise decisions which determines the strength and skills of management who may be unwilling to publish such policies (e.g. the need to cut labour resources in times of recession).

2.4 It is unlikely that any organisation will be willing to report that it does not have the governance structure to support its ability to create value in the short, medium and long term where such is the actuality. The only way to minimise the impact of this difficulty would be to require the IR to be prepared by an independent third party suitably qualified professional, which would be unacceptable on the grounds of additional costs and bureaucracy and may still include unreliable and unverifiable information provided by management to the independent preparer.

2.5 The publication of an IR with negative aspects can be self fulfilling in that reported contingencies may crystallise purely as a result of the publication of the IR.

2.6 Historically business disasters and crises have arisen as a result of the attitudes and philosophies adopted by the management of an organisation and would not have been avoided solely by tightening accounting regulations. We see the requirement to produce an annual IR as an opportunity to provide stakeholders with an insight into the attitudes of management, as well as an incentive to management to adopt appropriate philosophies. Even so, IR's are likely to be prepared with a bias towards optimism rather than prudence.

2.7 It is our view that for the benefits of IR to be optimised it is imperative that there is no need for the contents to be edited. As a consequence, we believe that IR should be compulsory as an internal report for organisations other than those which are owner managed. The minimum size of organisation to which IR should be applied is one which has a formal management structure with at least, say, three individuals responsible for ultimate decision making as regards the organisation`s activities (e.g. the board of directors) so as to provide a basis for joint and several responsibility by the members of the ultimate managing body for the contents of the IR.

2.8 In this way, the management of the organisation can demonstrate that they have addressed all of the aspects required to be reported in the IR without any exclusions, providing a degree of accountability to each other, and should the organisation suffer a disaster, if called upon by relevant authorities, to illustrate a proper approach to management of the organisation. The organisation can also be free to choose to whom it might issue the IR (for example to its bankers to support lending) but it will have no reason not to produce an IR which is complete, factual, unbiased and a highly useful tool to the organisation itself.

2.9 However, in the case of publicly accountable organisations (such as publicly funded bodies, not-for-profit organisations and charities) it could be considered appropriate that the IR should be required to be publicly published on the basis that all of the public at large are stakeholders (or potential stakeholders) and in such an organisation no matters required to be disclosed in the IR should be considered sensitive.

2.10 It is against this background view of the IR being a confidential document primarily intended for the benefit of the management of an organisation that we have provided answers to the specific questions raised in the Consultation Draft.

3 CONSULTATION QUESTIONS

Chapter 1 – Overview

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

3.1 We agree with the Guiding Principles set out in the Consultation Draft but would wish to stress the importance of the need for "Reliability and Completeness" in each IR in that the main benefits of an IR are lost when any sensitive information is omitted, as by definition, such information is critical to the organisation concerned. Similarly there should be no requirements which might lead to management not providing reliable and unbiased information, such as might be the case if the IR were required to be published.

3.2 We also consider that "Comparability" should not be included as a Guiding Principle, in that each IR should be specific to the circumstances of the organisation and any comparability with other organisations which might arise is a secondary benefit, so as to avoid any expectation of stereotyping the format and content of an IR.

3.3 We consider that the main objectives of the Framework should be to provide guidance as to best practice in managing value creation over time from all of its resources for organisations with a structured management.

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

3.4 It should be possible for entities to incorporate the IR principles within existing corporate reports and in particular the annual report as there are some areas of overlap and users will find it easier and more helpful to find the information in one place and in one report rather than in separate reports. It would also make the data gathering and assurance processes more efficient and cost effective.

Q3. 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?

3.5 While an online database of authoritative sources of indicators or measurement methods developed by established reporting standard setters and others would be most helpful to organisations in preparing an IR, it is likely that it would need to be industry based as regards indicators, and therefore wide ranging, although there may be some measurement methods which could be adopted over a range of industries. Consequently, a database of basic measurement methods may be relatively easy to establish but a database of indicators may need to be developed over a period of time, possibly in co-operation with relevant industry representative bodies.

3.6 The main references that should be included are:

- the Global Reporting Initiative
- Accounting for Sustainability 'A4S'
- The economics of ecosystems and biodiversity
- IFAC

Q4. Please provide any other comments you have about Chapter 1.

3.7 Chapter 1 provides a good overview of IR and we have no further comments on this chapter.

Chapter 2 – Fundamental Concepts

The Capitals

Q5. Do you agree with this approach to the capitals? Why/why not?

3.8 There is likely to be a conflict of interests between the needs of management and the needs of other stakeholders in terms of the content of the IR.

3.9 Management will need full information, especially that relating to weaknesses and threats and any other issues which might impact on viability which they may not wish to be known to certain other stakeholders. Customers and suppliers with a full knowledge of these factors may be able to use them to their advantage and to the disadvantage of the reporting organisation.

3.10 It has to be recognised that “for profit” organisations would by definition, consider the creation of financial capital as the main output and other outputs will arise only in so far as they contribute to the “financial capital” objective. For example, an organisation is likely to adopt a policy of being a "good employer" insofar as it achieves improved financial returns rather than for purely altruistic reasons.

3.11 If an organisation's approach to its capitals is as it has been set out in Section 2B then it is important that the IR should reflect this fact so that users of the IR have a proper understanding of the ethos of the organisation.

3.12 Possibly the most useful element of the contents of the IR is the culture, ethics and values of the organisation but probably these are the most difficult to ensure that they are fairly reported by the organisation as there will be a great reluctance to report any negative statements in this respect.

3.13 The exercise of preparing an IR will require a significant time commitment on the part of the compiler as well as needing open access to all aspects of the organisation, including information which is privy to top level management. It will also require a depth of understanding of the organisation's activities so as to determine what matters are material and so may need to be carried out by a member of the senior management team, with organisations reluctant to dedicate the time and incur the costs of such an exercise. To overcome this problem it will be necessary to be able to illustrate the benefits of an IR to organisations as well as providing assurances that they will be able to control the extent of the publication of the IR.

3.14 We think IIRC could consider if 'information' is worthy of its own discreet heading as one of the capitals rather than it being rolled into intellectual property and hinted at in others. Our reason for asking IIRC to consider this point further is that it would then lead to a focus on how efficient and effective organisations are at identifying, gathering, interpreting and using the intelligence gained from business information.

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

3.15 The measurement of natural capital is still in its infancy. This fact should be recognised and acknowledged by a statement on how IIRC views how this area of accountancy can best be developed.

Business Model

Q7. Do you agree with this definition? Why/why not?

3.16 We agree with the definition of "Business Model" but would suggest that it should be cross referenced forward to Section 4E in order to have a full understanding of the definition. The definition could be improved by including some coverage of the decision making process involved in how a business responds to change, opportunities and risk.

Outcomes

Q8. Do you agree with this definition? Why/why not?

3.17 We agree with the definition of "Outcomes" as it includes the fact that the outcomes can be both internal and external but would suggest cross referencing to Section 4F, as well as a clarification that "Performance" has the same definition as "Outcomes".

Q9. 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 (Section 4E).

3.18 We have no other comments to make on Section 2C or 4E.

Other

Q10.Please provide any other comments you have about Chapter 2 that are not already addressed by your responses above.

3.19 We have no other comments on Chapter 2.

Chapter 3 – Guiding Principles

Materiality and Conciseness

Q11. Do you agree with this approach to materiality? If not, how would you change it?

3.20 While the Consultation Draft explicitly states the Key Performance Indicators do not need to be specifically identified for the IR, we believe that the nature of such are at the heart of "materiality" considerations as defined in Sections 3D and 5B, particularly in respect of "for profit" organisations. Such is undoubtedly appropriate to determining materiality issues and should be acknowledged in the Guidance.

3.21 The use of the word "materiality" has an implication of application to quantified amounts and might be better replaced by the term "significant relevance" as more appropriately applied to concepts and intangibles.

Q12. Please provide any other comments you have about Section 3D or the Materiality determination process (Section 5B).

3.22 We have no other comments on Sections 3D or 5B other than we would expect that this area of the guidance would evolve in parallel with guidance in this area provided by authoritative audit guidance regulators.

Reliability and Completeness

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

3.23 One view is that the reliability of any IR will be difficult to establish. The content comprises primarily matters of subjectivity, opinions, and can reflect the bias of management in determining material matters for report and therefore the completeness of the report. In particular, matters identified by management as commercially sensitive and therefore omitted from the IR may be difficult to challenge. It is not realistic to expect that an independent review can form the basis of assurance of reliability. The degree of reliability of the IR is likely to be more assured if the IR is primarily used as an internal management tool as it is then in the interests of management to seek to achieve reliability in an unbiased approach to its preparation. Once exposure to other stakeholders is anticipated, there will inevitably be bias in its presentation.

3.24 An opposing view is that some form of assurance report should be considered. Medium and larger sized audit firms provide such services as part of their core offering. We would expect some of the assurance work to be covered as part of the annual statutory audit process anyway e.g. the statutory auditor's consideration of materiality and risk. So as long as the assurance cost is not a barrier to adoption it would be beneficial. We believe that consideration should be given to an exemption from assurance similar to that of external audit requirements for smaller entities.

3.25 AAT can see both sides of the argument which needs further discussion and consideration as a form of assurance may result in an increase in the degree of 'perceived confidence' in the reliability of the information. However, whether the 'perceived confidence' is directly proportional to the increase in statistical reliability of the information is another issue.

Q14. Please provide any other comments you have about Section 3E.

3.26 We have no other comments on Section 3E.

Other

Q15. Please provide any other comments you have about Chapter 3 that are not already addressed by your response above.

3.27 We have no other comments on Chapter 3.

Chapter 4 – Content Elements

Q16. 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).

3.28 We recognise that the content elements of the IR Framework are based on the principles of SWOT analysis, together with a Business Plan which are traditionally the tools required by potential lenders and investors and as such consider the content elements to be entirely suitable for an IR.

3.29 It would appear that the Framework is proposing that the conclusion be published in an IR is the "Future Outlook" (Section 4G). However we consider that the key emphasis of an IR should be on the viability of the organisation (and not profitability).

3.30 In particular, the main resource of an organisation in ensuring future viability is its "goodwill", not in the sense of a measure of ability to generate profits, but in the sense of its relationships with customers, suppliers, employees and other stakeholders, which ensures continuity of activities and the ability to generate value from these relationships over time.

3.31 We would suggest that "Viability" (or "Goodwill") is of such importance to warrant being separately addressed at the end of Section 4G under "Future Outlook".

Chapter 5 – Preparation and Presentation

Interest of those Charged with Governance

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?

3.32 We consider that each of the individuals comprising the management team responsible for the IR should formally acknowledge their responsibilities and confirm acceptance of the IR by "signing off" the Report. We believe that joint and several liability for the IR is an important safeguard against any recklessly prepared Reports. It will also ensure that the IR is given the attention and resources needed within an organisation to comply with the framework and be considered at the appropriate level within the organisation.

Q18. Please provide any other comments you have about involvement of those charged with governance (Section 5D).

3.33 We have no other comments to make on Section 5D.

Credibility

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

3.34 One view is that there are great difficulties in providing independent verification of the contents of an IR given that the information provided is largely subjective and unquantifiable. In particular, if organisations are permitted to exclude information on the grounds of sensitivity, it becomes a matter of opinion as to whether the IR is as complete as it should be. However, if the IR is intended to be an internal document, any other stakeholders wishing to place reliance on it will need to decide and agree with management the level of "due diligence" assurances they will require for their purposes.

3.35 An opposing view is that the assurance report should cover the whole IR as it is critical that users receive the maximum benefit from the assurance process. The content elements of an IR need to be consistent and are connected with each other it is therefore appropriate for all elements to be covered.

3.36 AAT's view on this issue is as we have set out in paragraph 3.25 above.

Q20. 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.

3.37 As stated in our response to Q19 above, we do not consider it is realistic to be able to provide criteria as the basis of an assurance engagement.

Q21. 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).

3.38 We believe that every legal body of a size which has a formal management structure should be required to produce an IR. In a group structure this may result in subsidiaries providing identical IR's where they are under common management. However, a legal body which operates on a divisional basis with separate management structure within divisions should be required to produce a separate IR for each division, supplemented by an umbrella IR in respect of the overall management of the organisation.

Overall View

Q22. Recognising 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 organisations in preparing an integrated report and for providing report users with information about an organisation's ability to create value in the short, medium and long term.

3.39 Taking a general overview of the framework, we consider that it provides appropriate guidance to organisations to enable them to produce IR's primarily for the benefit of the organisation's own management and also for the benefit of other stakeholders. It should assist in improving the quality of management decisions and recognition of its accountability for those decisions, and enable all stakeholders to have a full understanding of the significant aspects of an organisation's operations and its philosophies.

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 be given priority? Why?

3.40 It is difficult to prioritise any individual topics to be given priority in developing explanatory material on IR but we consider that it would be helpful to produce an example of an IR to illustrate the depth of commentary expected to be given or whether bullet points are adequate, and the method of cross referencing to other reports, particularly financial statements.

3.41 Whilst not prioritising as such, it would be useful to highlight examples of indicators and measurement methods developed by others, given the work conducted by the Accountancy Bodies Network on matters such as capital investment appraisal and the extensive authoritative body of work undertaken by the GRI, these should be communicated as sources for best practice by IIRC.

3.42 Natural capital is a topic that needs to be highlighted given that:

- measuring the value of natural capital is still in its infancy but is critical to how today's businesses should be measuring their value added
- the current and future demands being placed on our natural resources
- population growth and climate change are real issues and the accountancy profession needs to invest time and effort to supporting initiatives to tackle these issues.

3.43 In developing explanatory material we believe that consideration should be given to smaller entities applying the framework. These entities tend to be limited on resources and time and need all the support they can get especially free and online to identify the benefits to be gained from IR.

Other

Q24. Please provide any other comments not already addressed by your responses to Questions 1-23.

3.44 Whilst not a matter of overriding importance we suggest that consideration is given to whether the diagrams contained in the Consultation Draft provide a useful function in helping in the understanding of the associated text. For example, we do not think that Figure 1 adds to understanding the text. It is very difficult to interpret the significance of Figure 3, particularly as regards the topics which encircle the “Business Model”. Figure 4 is confusing in that the footnote disclaims the representation of a hierarchy which is the clear implication presented by the diagram.

3.45 We do not have other comments to offer that have not been covered elsewhere.

4 CONCLUSION

4.1 If an IR is primarily confidential to management, it is more likely that it will be complete and unbiased with the prospects of improving management decisions.

4.2 It is our firm view that in order for IR to be fully effective it should be introduced as a mandatory requirement (possibly by statute) that it be produced by the management of organisations on an annual basis as an internal document to support the annual financial statements, with the auditors report in the financial statements confirming that such a document has been prepared in accordance with the format required by the IR Guidance (but without any assurances as to the contents). Organisations should be free to choose any wider publication to other stakeholders or to retain the document as a confidential internal management tool.

4.3 It is difficult to impose penalties for the improper preparation of an IR by an organisation. However, in the event of the financial failure of any organisation, there should be a review of its IR’s to establish any negligence on the part of the management contributing to the failure and any personal liability for the consequences of the failure. The absence of an IR would be construed as negligence in itself.

4.4 We congratulate the IIRC on the contents of their draft framework paper and feel that this will provide support and clear guidance to those who will go about preparing an IR. It brings together the principles, key elements and contents of such a report. Having read and considered the paper several times it makes the reader think about how they can apply the framework to their own entity and it does make you think why have we not done this already. It is a very positive step forward for corporate reporting and also provides a useful tool for organisations to use on a day to day basis to deal with critical business issues that they may come across such as dealing with silos in organisations by way of one example.

If you would like AAT to participate in further consultation activity then please contact us at:

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4th July 2013