Submission to IIRC – copy of PDF submitted

15 July 2013

Dear IIRC,

As a professional having worked with leading organisations in many different countries exploring extra-financial reporting and Integrated Reporting for more than a decade, I commend your well thought-through Framework.

The key barrier to address for the successful take-up of this Framework is the lack of intelligent and strategic *Integrated Thinking* among senior management and those charged with governance in most companies. This implies that the current lack of <IR> styled communication from most companies is not the lack of disclosure, but rather the lack of *Integrated Thinking* required for creating value over time and for good quality <IR>.

I salute many of your elegant solutions in the Framework to encourage Integrated Thinking - including the lack of making strict requirements on form and content, but rather to provide principles and guidance on how to prepare <IR> - based on a broad consideration of impacts and value creation that the business has - and through encouraging a process of answering key questions to meet the principles defined in the Framework.

My comments comprise two key proposals to further strengthen the Framework's requirement for *Integrated Thinking*:

- Adding a principle of *'Through the eyes of the Directors'*, refer response to Q1
- Broadening the objective and audience to include key Corporate Governance decisions, such as shareholders' discharge of the Board of Directors, refer response to Q4.

For your information, my background to provide my comments include significant work with leading companies working on Integrated Reporting for over a decade as well as exploratory research on how Board and its Non-Executive Directors achieve what in your Framework is termed *'Integrated Thinking'* as a requirement to enable <IR> styled reporting.

Please do not hesitate to contact me if you have any questions regarding my comments.

I wish you luck - successful take-up of the <IR> Framework has the potential to add significant value to companies and societies.

Kind regards,

Leon Olsen
Principal, Insight ResponsAbility*

* I am currently engaged as Head of Sustainability at Golder Associates. My comments and responses to the IIRC on its draft Framework are my own personal comments. Insight ResponsAbility is my own entity.

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

<IR> should be made '*through the eyes of the Directors'* or an equivalent Governance level – and this should be a key principle of <IR> as it is the quality of 'Integrated Thinking' at Board and senior management level that is the key driver of deliberate Governance and management of the creation of value over time, as well as good quality <IR>.

<IR> should reflect the Directors' (or equivalent Governance body's) view on how the company is aiming to create and delivering value over time. Transparency on the state of 'Integrated Thinking' at the highest level of Governance is important for three key reasons:

1. To support report users in their assessments as to the state and sufficiency of 'Integrated Thinking' at the company needed to support the creation of value over time, supporting their financial capital allocation decisions
2. To hold the Board to account on their level of 'Integrated Thinking' to support and sustain the creation of value over time – this is particularly important for the stakeholders with formal oversight ability, such as shareholders, to enable them to monitor, assess and engage on the Corporate Governance approach of the companies they have stakes in
3. The draft framework acknowledges that 'Integrated Thinking' is a key aspect of achieving good quality <IR>. Said differently, the lack of <IR> from most companies is not because of a lack of quality disclosure and reporting, but rather a lack of quality in 'Integrated Thinking' at Board and senior management level. The key gap to bridge in achieving the vision of <IR> is therefore 'Integrated Thinking'. Adopting the *'through the eyes of the Directors'* principle directly supports this assertion – as is, there is insufficient support for this key assertion, as no other principle directly addresses this key aspect for good quality <IR> (although the Materiality principle does incorporate elements of it, refer response to Q11).

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

Broadly, yes.

However, a better description or outline of how <IR> is linked or aligned to the mandatory reporting in many jurisdictions by the Directors or senior management of the company in its annual report (e.g. the 'Directors' report' or 'Management Discussion & Analysis') would be helpful.

In many jurisdictions this report – at least notionally – is supposed to cover a lot of the same reporting as <IR> as it requires the company to disclose all information that is material to its shareholders or potential investors in their financial allocation decisions. I.e. it is notionally supposed to support the same objective as <IR> - it therefore begs the question how <IR> is linked or aligned to these mandatory requirements?

Also, refraining from prescribing specific indicators or measurement methods as outlined in paragraph 1.19 is appropriate as it bears a high risk of encouraging 'Boilerplate reporting' seen in many other domains of reporting. <IR> has to build on a better level of intelligence at the highest level of Corporate Governance and senior management at companies – the 'Integrated Thinking' required for the creation of value over time. Prescribing specific indicators or measurement methods has a tendency of reducing the reporting process to a technical exercise, distracting from the need for intelligent *thinking* required at companies engaged in <IR>. I therefore commend and support the IIRC for this approach in the draft framework.

Q3 – If the IIRC was to create an online database of authoritative sources of indicators and measurement methods developed by established reporting standard setters and others, which references should be included?

Overall, I have no comment of substance in respect of authoritative sources to offer as comment.

Rather, at this point in time I do not think it should be the priority of the IIRC to provide authoritative sources for these matters, as it increases the risk of boilerplate reporting, to the potential detriment of the intelligent *thinking* required for the creation of value over time and good quality <IR> as outlined in response to Q2.

In time, I would encourage the IIRC to offer guidance (rather than authoritative sources) for indicators and measurement methods. Authoritative sources should only be developed once <IR> has matured further and with proper engagement with relevant stakeholders.

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

The objectives and audience of <IR> should be broadened to also inform key Corporate Governance decisions, such as shareholders' discharge of the Board of Directors and the approval of the annual Integrated Report from the Board of Directors to its shareholders. This is important because:

1. Integrated Thinking is (as described above) critical for the creation of value over time and good quality <IR>. Consequently, the company's Board of Directors should be expected to be held to account for its quality of Integrated Thinking by the existing formal Corporate Governance mechanisms. Such accountability could be a key mechanism in supporting the take-up of Integrated Thinking and good quality <IR>
2. Shareholders that invest with a longer-term view are the capital providers most likely to be interested in <IR>. They are looking for shares with value-creation potential over time, and will often hold shares for longer than other investors that may be looking for shorter term gains through market movements. Therefore, they are often less interested in the effective allocation of capital in the short term. Their preferred response to a company underperforming in the short term may be engagement through the Corporate Governance mechanism to seek improvement in value creation over time, rather than through selling or shorting the asset. It follows that effective <IR> should directly aim to support this type of capital provider to more effectively enable their engagement with Boards of Directors in order to encourage better Integrated Thinking for value creation over time, and better quality <IR>
3. Without basing the reporting on an official Corporate Governance mechanism capital providers wanting to encourage Boards of Directors to consider <IR> and Integrated Thinking are not given as strong an endorsement by the Framework to engage companies on these matters. It therefore becomes easier and more legitimate for the Board and senior management to reject any shareholder pressure for increased Integrated Thinking and <IR>, in particular as they are not supposed to be officially held to account for it. In this respect it

should be noted that engagement through the Corporate Governance mechanism often is a key driver of getting companies to consider broader aspects of relevance to the business in its value creation. This is in line with 'active ownership' increasingly being advocated as a key aspect in ensuring improved value creation over time. I.e. the formal Corporate Governance mechanism is likely a key driver for the successful take-up of the <IR> Framework.

It can and has often been argued that the objective of meeting the needs of the providers of financial capital in order to support their financial capital allocation assessments will also meet the information needs of shareholders aiming to hold the Directors to account through the Corporate Governance mechanism. However, little empirical research as to whether this is truly the case has been made. Rather than empirical evidence, the argument is a normative induction based on traditional financial markets theory whereby the informed capital market will price an asset based on an assessment of the Net Present Value of its discounted future cash flows – and therefore also be based on a true appreciation of the value creation potential over time. However, it is doubtful that the market effectively makes this appreciation for a number of reasons, which may include imperfect information about the future but also a disregard for externalities. By focussing exclusively on capital allocation <IR> appears to seek to address this directly.

However, this perspective fails to appreciate that some providers of financial capital are looking for the type of information <IR> should provide not to price the asset effectively, but rather to assess the quality of Integrated Thinking as a gauge on the quality of the Board and Senior management in creating value over time. Whilst this can be part of the information for effective capital allocation, it may not be – and as the capital allocation argument is based primarily on a normative inductive hypothesis rather than empirical evidence, it appears folly to base <IR>'s objective and audience solely on this.

Given that financial reporting for many decades has had as its objective to support efficient capital allocation, it begs the question why it has as yet apparently not delivered the information <IR> seeks to deliver to improve capital allocation? Focussing primarily on capital allocation also has a tendency to focus on shorter-term asset price movements rather than on longer-term value creation. It follows that focussing primarily on the information needs to facilitate capital allocation inherently may also have a tendency to support short-term trading rather than the creation of value over time.

Finally, it should be noted that although I do believe it should be broadened I generally agree on focussing on a narrower objective and audience than many proponents of <IR> would like. Too broad an objective and audience is likely to make the application and practice of <IR> more difficult. If <IR> tries to be everything to everybody it increases the risk of being of little value to anyone. A more strategic approach on key corporate report users is therefore appropriate, as it has a better chance of engaging the Board and senior management required, thereby fostering the *Integrated Thinking* required. I believe the proposed broadening of the objective and audience increases the probability that the Framework will deliver on this note.

Q5 – Do you agree with this approach to the Capitals? Why / why not?

The 'Capitals' in Section 2B is likely to be a challenging model for many company Boards and senior managements to get their head around. This is in part due to it requiring thinking and reflection on a number of areas they may be unfamiliar with and that may not fit easy into the way in which they Govern and manage the company.

That said, I broadly agree with the approach because it:

- Encourages Integrated Thinking – companies engaging in <IR> have to reflect seriously about the broad aspects that may be relevant to the value creation, transformation or destruction their company is engaged in. <IR> requires Integrated Thinking, without it <IR> is difficult (if not impossible) – with it, it is relatively easy.
- Is not made mandatory to report based on the Capitals – rather, the Capitals is offered as a required guide in establishing whether the company has considered the broad spectrum of aspects required for good quality <IR>
- Through its 'resource-based' view the Capitals can enable an coherent value creation analysis and thus support an instrumental value creation narrative supporting a strong business model and thus a good narrative for <IR>
- Deliberately is different than other models / frameworks that encourage extra-financial reporting, in particular with its instrumental 'resource-based' strategic view. This encourages companies to look at extra-financial issues in a different and more strategic paradigm that may resonate more easily with the Board and senior management.

It should be noted that the instrumental 'resource-based' view also has a number of conceptual implications. For example, companies that may be operating a business model based on a different strategic paradigm may find the Capitals less useful than companies operating within that paradigm. As such, the Capitals also risk narrowing strategic thinking to instrumental 'resource based' strategic views, which hardly would be the aim of <IR>.

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

Due to the challenges many Boards and senior managements are likely to face in applying the Capitals, the IIRC should continue developing further guidance on its appropriate use in preparing <IR>. Including better practice examples and case studies to illustrate how it can be done would be particularly useful.

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

Broadly, I agree with the definition of the business model, primarily because it:

- Fits with the instrumental resource based view promoted by the Capitals and encourages strategic Integrated Thinking by the company on how it creates value over time
- Is not made mandatory to report based on this definition of the business model – rather, the business model is offered as a guide on how to think strategically about how the company creates value over time as part of preparing <IR>.

Again, it should be noted that the instrumental 'resource-based' view also has a number of conceptual implications, as mentioned in response to Q5.

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

Broadly, I agree with the definition of outcomes, in particular because it encourages companies to consider the broader value creation, transformation or destruction that the company is engaged in – conceptually by linking it to the impact the outcomes has on the Capitals.

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).

The IIRC should continue developing further guidance on the use of Business Models in preparing <IR>. Including better practice examples and case studies to illustrate how it can be done would be particularly useful.

I agree on the provision in paragraph 4.24 on reporting all material constituent business models in diversified organisations. Whilst this could conflict with the aim of concise <IR>, I believe the provision is appropriate and for large diversified organisations the Board and senior management must be trusted to make a sound decision as to what warrants inclusion in <IR>, based on the materiality process.

I believe the provision in paragraph 4.25 should be tightened. I agree that for corporate centres acting primarily in investment management activity, the relevant business model is likely to be that for the corporate investment management rather than all the underlying investments. However, I believe the provision is a bit loosely defined and may leave some organisations to misinterpret it to avoid being transparent about their business models. I believe the provision is and should be an exception to the main provision in paragraph 4.24 and should only be available for truly diversified investment management vehicles.

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

Emphasising the flexibility in meeting the requirements of Chapter 2 is important. I believe the Framework already does emphasise this flexibility. However, the IIRC may consider how it can further strengthen this emphasis. It is the quality of intelligent and strategic *Integrated Thinking* informing good quality <IR> that should be the aim of these concepts – rather than the rigid use of these guiding concepts.

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

Yes, I broadly agree.

In particular, I commend the focus on the view of senior management and those charged with governance being the deciding factor as to whether a matter is material. This is in line with my response to Q1 above about the addition of the principle *'Through the eyes of the Directors'*. I suspect many proponents will argue it is insufficient, and should be based on a broader stakeholder based view of materiality, such as used in sustainability reporting.

Whilst I am generally a proponent of sustainability reporting, I disagree strongly with this stakeholder based view for materiality for <IR>, as it dilutes the transparency for report users and other stakeholders as to what senior management and those charged with governance really view as material to the business in a strategic sense. Instead companies may prepare nice reports that obscure this view for report users and other external stakeholders. I believe report users and external stakeholders are better served by understanding what senior management and those charged with governance truly believe is material, and if they disagree they can calibrate their engagement with the company accordingly. I also note that the Framework appropriately includes a separate principle for 'Stakeholder Responsiveness', and therefore is not neglecting this important aspect of good quality <IR>.

Basing the materiality determination on the view of senior management and those charged with governance enables external review and assurance by comparing the reported matter to the documented deliberations of senior management and those charged with governance. If a matter is reported simply to meet external stakeholder demand, but it is not in any significant way discussed by senior management and those charged with governance, an external assurance provider should be able to challenge the company on why it is including the matter in its <IR>. Similarly, if a matter discussed by senior management and those charged with governance is excluded from <IR> an external assurance provider should be able to challenge the company on whether this exclusion is appropriate.

In addition to this, I also agree with the following concepts in the materiality approach:

- Focus also on *potential* to substantively affect value creation over time. Including potential effects, e.g. from hazards that potentially could have significant negative value, is important for good substantive <IR>
- Focus on both negative and positive matters – obviously, it can be expected that companies will prefer to focus on positive matters, however, an appropriate process will also include negative matters with equal emphasis as appropriate
- The regular engagement with the primary intended report users to identify their information needs. My response to Q4 on broadening the objective and audience to support the formal governance mechanism is further supporting this engagement, adding further value to the Framework
- The requirement to aim for concise reporting. Whilst this can be challenging, a concise strategic report focussing on the most material matters is likely to add more value than a long report reporting on all potentially material matters.

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

I generally agree with the outlined process and materiality framework. This includes the requirement to disclose the process applied as well as the guidance on how to assess importance with matters of potential high magnitude but low likelihood of occurrence being material due to the significant effect they potentially could have on the business.

However, it should be noted that this can be particularly difficult for some organisations where there could be a number of separate potential high magnitude events that cannot be consolidated. This may imply that the organisation would have to separately report on each of these events and how they are managed, even as they are all deemed to be unlikely – which may imply a report that is no longer concise. However, it is likely to be the right approach, even if it comes at the expense of concise <IR>. This is because if there are many separate potential high magnitude events, then it is most likely critical for the intended report users to be informed how they are all managed.

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

As outlined in paragraph 3.41 the information provided in <IR> should by nature be central to running the business. Therefore, providing a coherent strategic narrative based on Integrated Thinking by senior management and those charged with governance is central to the reliability of any integrated report.

In addition, external assurance may add further credibility, see response to Q19.

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

I generally agree with the concepts of Section 3E. Obviously, the requirements for balanced and complete reporting may be a challenge, as many companies may be tempted to bias reporting towards positive aspects of their performance.

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

I agree with the strategic focus and future orientation of the reporting. The more instrumental <IR> can be in supporting the strategic drive of senior management and those charged with governance the more likely it is to be applied by them. Their application and take-up of *Integrated Thinking* is – as mentioned – critical to the take-up and success of the <IR> Framework.

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).

I commend the approach of <IR> not having rigid form and content requirements, but rather having to answer key questions for each of the content elements. Whilst this is likely to frustrate many prepares of <IR> as they seek to outline and tick-off the specific requirements, it is the right approach as it encourages intelligent thinking – rather than boilerplate reporting (refer also response to Q2).

Aside from this, I have no further comment – I like the content elements and the key questions and their guidance.

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?

Yes. In line with my response to Q1, <IR> should be prepared '*through the eyes of the Directors*' and to cement this, the Directors should confirm that they have prepared it accordingly and in line with the requirements of <IR>. This will support their involvement in <IR>, and they need to be involved, as <IR> has to be supported by Integrated Thinking at Board level.

Obviously, any requirement of this nature will likely have to work in tandem with any legal or mandatory requirements or implications from such a Governance statement and sign-off in the report. Acknowledging this relationship within the Framework is probably helpful (refer also response to Q2).

Q18 – Provide any other comments you have about involvement of those charged with governance (Section 5D)

No further comment – please refer to my responses above.

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

For the moment, I believe assurance of <IR> should be voluntary – however, it would likely benefit from a more defined approach to assurance, and longer-term with a mandatory assurance framework.

Key to answer the question as to what should be assured (i.e. what subject matter to focus on) is the consideration of what value the assurance will provide to the organisation and the users of <IR>?

Initially, external users are likely to be more interested in whether the <IR> process is appropriately applied using all or some of the key principles of the framework in the process of preparing <IR>– rather than the accuracy and completeness of all the various assertions provided in <IR>. They are likely to more concerned with whether the <IR> disclosures are reflecting true *Integrated Thinking* and covering all material aspects, both negative and positive, rather than whether the assertions provided are complete and accurate. Said differently, they are initially likely more interested in obtaining assurance as to whether the reporting covers all relevant information, and less on whether the information provided is complete and accurate.

I believe this type of assurance is also better suited at challenging senior management and those charged with governance to improve in their *Integrated Thinking*, as assurance providers will scrutinise and challenge them on how they identify, assess and prioritise matters. This, however, may require a different skill set than what most current company auditors possess – certainly, it requires a different type of investigation and assurance procedures evaluating against a largely qualitative set of criteria, rather than the mostly quantitative and financial set of criteria they usually assure against.

It follows that it is likely to be valuable for the IIRC to work with relevant stakeholders to define the approach to assure whether the materiality principle has been appropriately applied in preparing <IR>; and subsequently whether the broader Framework has been appropriately applied. Such guidance could significantly improve the quality and consistency of such assurance to the benefit of the intended users and take-up and value of <IR>.

Assurance over the completeness and accuracy of specific assertions can – at least for the time being – then be left to the reporting organisation to determine in collaboration / engagement with its report users and assurance providers.

It should be noted that leading sustainability report assurance has grappled with the challenge of assuring whether a report comprises all the relevant (i.e. material) disclosures it should, based on the company's own process. This has often been based on the AA1000 AccountAbility Principles

Standard providing the basis for the evaluation criteria. The IIRC therefore has a good starting point for defining this approach, given also the strong guidance it is providing for the Materiality determination – which incidentally also appears to have been inspired by the original work by AccountAbility and its stakeholders in defining like processes (which subsequently was transferred to the GRI Guidelines as well).

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.

I have no further comments about Section 5E.

As I have performed and lead significant work on leading assurance for similar reporting, I offer also comment on the suitability of assurance criteria.

The question on 'suitable criteria' for an assurance engagement is a step too far in considering whether an assurance engagement can be performed. In line with my response to Q19 it is necessary to first consider what should be assured – i.e. what subject matter should be assured? Only when this clarified can the suitability of the criteria to evaluate whether the subject matter has been appropriately reported according to the criteria be assessed.

In line with Q19 I believe that further guidance to define an agreed approach for assurance would be beneficial. However, without such guidance, voluntary external assurance should in my opinion still be possible, provided that:

- The reporting organisation and the assurance provider can agree on a defined subject matter – e.g. whether the materiality process has been applied to identify, assess and prioritise material matters to include in the report
- The reporting organisation defines and discloses its criteria for disclosing that subject matter – e.g. disclosing the materiality process as required
- The reporting organisation applies and documents its approach for preparing the subject matter – e.g. documenting its process for each step of the materiality process
- The reporting organisation provides the assurance provider access to the evidence for this its adherence to the criteria – e.g. to relevant evidence in the materiality process, including access to interview key stakeholders engaged in the process.

This would be consistent with the approach taken in leading edge sustainability report assurance using the ISAE 3000 standard.

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 1 above rather than here).

I have no further comments of substance.

Q22 – 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 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?

As outlined above, the key challenge is to achieve intelligent and strategic *Integrated Thinking* by senior management and those charged with governance:

- Without it <IR> as outlined in the Framework is difficult, if not impossible. These organisations are likely to find the principles and concepts proposed by the Framework too challenging to be of value to their own strategic deliberations
- With it, the Framework is likely to be workable and appropriate for use – although, it may still be challenging for these organisations.

The lack of intelligent and strategic *Integrated Thinking* by senior management and those charged with governance may significantly hamper the take-up of the Framework. If this occurs, the IIRC should establish whether this is due to the Framework being too complex or simply being ahead of its time and amend the Framework accordingly.

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

As per above, the critical driver for good quality <IR> is intelligent and strategic *Integrated Thinking* by senior management and those charged with governance. However, the gap to achieve this is in many companies enormous. In reality we are likely talking about a challenging paradigm shift in corporate boardrooms. As mentioned above, this can be a major barrier to the take-up of the Framework.

It follows that by far the most important additional material the IIRC can develop may be guidance on how companies develop *Integrated Thinking* by senior management and those charged with governance.

In line with this, I believe the IIRC should consider providing further guidance on how to apply the Capitals and Business Model concepts, as they should support *Integrated Thinking* – refer also responses to Q6 and Q9.

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

No further comments, except for saying: Well done so far, and good luck ☺