

CONSULTATION DRAFT OF THE INTERNATIONAL <IR> FRAMEWORK

CONSULTATION QUESTIONS

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

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

Please provide all comments in English.

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

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

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Stakeholder group: Provider of financial capital

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

Organization name:

Industry sector:

Geographical region:

Key Points

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

This response on behalf of APG and its clients is based on the response by the International Corporate Governance Network and also reflects additional thoughts expressed in the submissions by Global Asset Owners, NBIM and Hermes EOS.

We welcome this opportunity to comment on the draft framework from an institutional investor perspective. We also welcome the recent establishment of an Investor Testing Group to ensure that investor views are taken into account in the development of the Framework and subsequent stages in the evolution of Integrated Reporting.

1. **We believe the Draft Framework can help facilitate improvements in the quality and influence of corporate reporting, and the functioning of capital markets.** If embedded in international reporting and accounting standards and practices, the guidance provided in the Draft Framework can help investors and other stakeholders gain a fuller understanding of a company's business model, underlying strategy, and conditions for value-creation in the short-medium, and long-term. It has the potential to improve the reporting of information that is material to a company's value – such as risks related to changes in natural capital - that cannot be easily discerned from financial accounts. In turn, the increased transparency would be

supportive of well-functioning, legitimate and effective markets, and provide benefits to providers of financial capital and other stakeholders.

2. **We strongly support the Draft Framework's identification of financial capital providers as the primary audience of integrated reports.** (paragraph 1.6) We believe this is a prerequisite for integrated reporting to influence investment analysis and decisions. This specific guidance helps companies identify the purpose of integrated reporting and how to prepare an integrated report. We also support the Draft Framework's statement that 'information is only included in an Integrated Report when it is of practical use to the intended report users' (paragraph 4.16) This reinforces our view that Integrated Reporting is focused on improving the quality and conciseness of corporate reporting. An Integrated Report should be scoped to the interests and expectations of its primary audience, and thereby address the knowledge reader accustomed to reading annual reports and accounts, rather than an uninitiated audience. Notwithstanding this purpose, we believe most of what will be reported in an Integrated Report directed at investors would also be of interest to other stakeholders. Conversely, we believe an Integrated Report not directed at a specific audience will likely be of less value to all stakeholders, including investors.
3. **We believe the Draft Framework should explicitly recognize the primacy of financial capital in driving investment analysis and decisions.** The concept of 'the capitals' (paragraphs 2.12-25) is helpful in illustrating the broad sources of value that may underpin the financial performance of companies. We agree that other forms of capital – manufactured, intellectual, human, social and relationship, and natural – can have a significant effect on the ability of a company to sustain value over time (paragraph 2.12), and this should be reflected in Integrated Reports. But the Draft Framework should recognize that investors ultimately look for a satisfactory return on their financial capital. Different forms of capital are not completely fungible. We agree that the primary reason for including the capitals model in Draft Framework is to provide guidance on scoping, and provide a theoretical underpinning to the concept of integrated reporting. (paragraph 2.19) In other paragraphs, the Draft Framework seemingly presents value creation as an aggregate value of all of the capitals, which in our view is unworkable. (paragraph 2.12) It is unrealistic to expect investors to accept unsatisfactory returns on their financial capital in exchange for positive returns on other forms of capitals, as the Draft Framework seems to suggest. (paragraph 2.16) In turn, we recommend that guidance on value (paragraph 2.13), and guidance on performance reporting (paragraph 4.27), is revised accordingly.
4. **We believe the Draft Framework should more strongly emphasize the importance of board involvement and external assurance.** The concept of Integrated Reporting should serve to strengthen the accountability relationship that exists between boards and shareholders. Boards of directors are responsible for the establishment of a strategy and policies securing business practices that are consistent with sustainable development, and communicating all matters material to the understanding of how a company creates and sustains value. Therefore, overseeing an Integrated Report, and the integrated reporting process more broadly, would naturally fall within the scope of Board responsibilities. We would recommend that the Draft Framework encourages those charged with governance to provide a statement of compliance with the integrated reporting framework. In our view, this should be mandatory. Board involvement also encourages coherence and cross-referencing between Integrated Reports and annual reports and financial accounts. With regards to quality, the influence of integrated reporting on capital markets is likely to increase if information is viewed by providers of financial capital as reliable, credible, and complete. Therefore, we suggest that the Draft Framework identifies as best practice that the external auditor performs a consistency check for the Integrated Report. External assurance, and other

mechanisms employed to ensure reliability, should be described in the report, as the Draft Framework suggests. (paragraphs 3.32)

5. **We believe that the Draft Framework should more explicitly provide strategic direction to companies and organizations that can help embed integrated reporting in capital markets.** The Draft Framework sets out in great detail *what* Integrated Reporting is. We would strongly encourage the IIRC to ensure that the final document serves as a genuine guidance document for the *how* of integrated reporting to assist preparers. For example, preparers would benefit from guidance on the use of standardized quantitative metrics to support integrated reporting. While we agree that qualitative narrative explanation is helpful and necessary (paragraph 2.24), we recommend that the Draft Framework more strongly suggests that qualitative information should be supplemented by rigorous quantitative metrics, where appropriate. This would allow companies, investors, and other stakeholders to more easily analyse and compare information across integrated reports, and over time. Although it is not within IIRC's mandate to develop metrics, the Draft Framework should elevate the reference to metrics to the level of a principle (paragraph 1.19). It should also provide general direction to relevant standard-setting organizations and industry bodies to develop metrics and key performance indicators (KPIs) suitable for use in integrated reports.

Chapter 1: Overview

Principles-based requirements

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

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

There are two parts to this answer: presentation and substantive content.

Paragraphs 1.11-1.12 provide a sensible rubric to encourage preparers to follow the framework and will assist users to absorb the information and to make comparisons. In addition to providing them in the context of specific chapters it would be useful to list them in one place for ease of reference so that repetition, as distinct from helpful emphasis, can be more clearly identified.

However, the key question is whether the principles found in bold and italic type throughout the document are themselves sufficient. By and large the answer is in the affirmative, although they can be vague in places, given the heavy emphasis on explanations of business models, risk and value creation over the short, medium and long term with reference to materiality.

We believe that reporting entities should be expected to define the short, medium and long-term in the context of their own specific strategy, business model and sector in order to explain how they view their time horizons and why.

Interaction with other reports and communications

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

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

Yes and this takes forward the aspiration to integrate rather than simply combine different types of report. It is also about encouraging behavioural change on the part of preparers (and for that matter users as well) in integrating thinking, reporting and analysis. We also agree that reporting should be seen as a dynamic continuous process rather than just as a retrospective snapshot.

We find it important to emphasize the need for providing updated information more frequently than annual, for example through the corporate governance section of the website. We expect a range of channels to benefit from the <IR> guidance including analyst presentations and regular updates.

The Integrated Report should *eventually* become the principal document that companies in any given jurisdiction are required to publish/ file. By this we mean that the Integrated Report should be the statutory Annual Report in those countries where companies are required to file an Annual Report, Annual Accounts and an Auditor Opinion. The latter should cover both the Integrated (annual) Report and the Accounts. In other jurisdictions it would be the equivalent of the financial statements, auditors' report, MD&A and corporate governance filings. The latter filings may need to continue to be available as supplementary detailed information.

We are delighted that IIRC and IASB have signed a MOU. Specifically we note that the IASB's Management Commentary guidance shows significant overlap with what is required under the IR Framework, and in our view it would be worthwhile to explore further to what degree the IR framework and the guidance for the IASB's Management Commentary could be matched.

We recognise that a consistent definition of 'materiality' is an important pre-condition for the applicability of the IR Guidance in the context of Management Commentary or similar disclosures.

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

This is a fast changing field and there are number of early stage initiatives.

A non-exhaustive list would include the following

- International Accounting Standards Board IFRS Practice Statement Management Commentary 2010
- DVFA Effas KPIs for ESG (2010)
- G4 GRI (2013)
- CFA Institute, 'Environmental, Social, and Governance factors at Listed Companies: a Manual for Investors' (2008)
- National references
- Accounting Standards Board (UK), 'Operating and Financial Review'
- Australian Institute of Company Directors & PricewaterhouseCoopers, 'Shareholder friendly report'

- Institute of Chartered Accountants in Australia, 'Extended performance reporting: an overview of techniques'
- Australian Securities and Investments Commission, Regulatory Guide 247 on the Operating and Financial Review
- Australian Securities Exchange (ASX), Listing Rule 3.1 and Guidance Note 8 on continuous disclosure
- Canadian Institute of Chartered Accountants, 'MD&A Guidance on Preparation and Disclosure'
- Deloitte, 'Added value, long term: non-financial sustainability key performance indicators on their way into financial reports of German companies' DVFA, Germany,
- The Norwegian Society of Financial Analysts, 'Recommended guidelines for the reporting of additional information on value creation'
- King Code of Corporate Governance for South Africa (King III)
- Universities Superannuation Scheme, James O'Loughlin and Raj Thamotheram, 'Enhanced analytics for a new generation of investor'
- US Securities and Exchange Commission, 'Management's Discussion and Analysis of Financial Condition and Results of Operations' ??
- SASB (North America)
- Project Delphi (Europe)

Other

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

Paragraph 1.3: we believe that it is important to include reference to an organisation's business model in the definition.

Paragraph 1.5: we think that any description of the IIRC's aim should include a clear reference to "assist companies to better communicate how, over time, they create value; avoid the destruction of value; and transform value creation for customers and other stakeholders into financial value for their investors and other providers of financial capital."

Paragraph 1.9 – 1.10: we think that another explicit objective of the <IR> framework is: to provide guidance to other organisations that define expectations for, and inform the practice of, corporate disclosure.

Paragraph 1.13: we think that the second sentence is an essential point that deserves greater emphasis and repetition throughout the document: "senior management and those charged with governance therefore need to collectively exercise judgement to determine which matters are material." We also think that the definition of materiality should be reviewed from both a functional and strategic perspective. If the IR framework is to inform the development of other disclosure

standards, then it is important that the definitions of materiality are, at very least, not considered inconsistent or incompatible.

Chapter 2: Fundamental concepts

The capitals (Section 2B)

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

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

Yes in principle. This is a helpful model to take forward integration. However metrics are less well developed for some capitals and need to be improved. Subject to this, the stock and flow of capitals provide helpful insight although it needs to be understood that investors will continue to require a satisfactory return on their financial capital.

We wish to point out that the use of the term Capital has triggered substantial discussions. Short of suggesting using different terminology for the Capitals other than Financial Capital, we instead wish to comment more broadly on Value.

Investors would like companies to report on value creation; how this value is created would be part of the Report but it would not be limited to it. From an investor perspective there is value that the company creates for itself and/ or value that it creates for others of which it then captures a part. Investors are eventually focussed on risk-adjusted returns, and wish to understand how the company increases its value (to shareholders) based on all the different capitals mentioned here. The current Framework presents value creation as an aggregate value of all of the Capitals which in our view is unworkable. Value creation should be presented from the perspective of the primary intended report users and one would not expect all ripple effects to be captured.

The current model does not sufficiently address a company's ability to generate profits and how sustainable its resources are. This would require acknowledging the interaction between the company and the individual capitals. Moreover, it would be essential that companies specifically address the value proposition for the customer.

To be clear, we consider it of vital importance that a company operates responsibly and takes due care of all the Capitals mentioned here; likewise stakeholders (other than shareholders) influence business drivers and their availability.

Whilst we wish to see the development of rigorous metrics for the other capitals it is unrealistic to expect investors to be content to see returns on other capitals as a substitute for unsatisfactory returns on their financial capital. In general though we caution against artificially monetizing eg the impact of certain capitals; we consider it in most cases implausible to create a mono-causal link between one factor and profit.

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

While we recognise that it would take significant effort to change, we believe that it would be worthwhile considering revising the order of the sections so that the document begins with "value creation". This is the core of the objective of the IIRC and of the <IR> framework, and we believe that

a clear understanding of what is meant by value creation would help users understand the other fundamental concepts.

We believe it is essential that the IR framework refer more directly and more often to value creation from the perspective of the organisation's customers.

We think that it would be useful to include some reference to "competitive advantage" in each of the three fundamental concepts. Most private, for-profit businesses think in the context of competitive advantage, and most investors look for insights into a company's competitive advantage. This seems like a striking absence at the moment.

Paragraph 2.3: we think that there are three elements that provide insight into the relationship between the 6 capitals and the organisations ability to create value: a) the absolute availability of the capital; b) the relative ability of the organisation to access the required quantity and quality of capital; and c) the relative efficiency with which the organisation uses (and develops) the capital.

We think that the IR framework does not give enough guidance to an organisation on the boundary of the IR or on the scope of management information that might be required. E.g. footnote 2, page 12: we think that this example should be deleted or changed. The current example suggests that it may be relevant for an organisation to track information that is beyond its reasonable capacity to collect, and which may well be of dubious value to the organisation. We think that paragraph 2.20 should be revised to state: "it would be impracticable, and indeed unnecessary, for a company to define every possible stock of value. Organisations must consider the appropriate boundary of their IR and the appropriate scope of their management information. As a result, the framework also does not seek to define every possible stock of value."

We do not think that the diagram on page 13 (figure 4) is of much value.

We think that paragraph 2.18 (i.e. not all capitals are equally important to all organisations) should be repeated at the front of the section on capitals.

Paragraph 2.22 should be revised to reflect three elements: a) the absolute availability of the capital; b) the relative ability of the organisation to access the required quantity and quality of capital; and c) the relative efficiency with which the organisation uses (and develops) the capital.

Paragraph 2.23: add reference to the fact that an understanding of who owns (or controls or influences access to) a capital may provide useful insight into the organisations expected future access to relevant capitals, and their affordability.

Business model (Section 2C)

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

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

Yes, although there needs to be some clear overarching purpose of the company that makes it unique. This should not be an overly onerous requirement as all companies should be able to describe their chosen business model. However it can be complex, so this might not be as straightforward as it appears.

We believe that it would be useful to add the concept of “value capture” to the definition. I.e. “... that aims to create and capture value ...” this is more consistent with the target audience for the <ir> framework, outlined in paragraph 1.10: “private, for-profit companies”.

We believe that it would be useful to add some additional guidance on how companies can communicate the nature of the “drivers” for materiality of non-financial capitals, including in particular in the future. One simple approach would be to refer to: a) scarcity (relative and absolute); b) rules (mandatory technical regulations and voluntary standards); and c) expectations (customers’ vis-à-vis products and services, and broader stakeholders as regards general corporate conduct).

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

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

Yes and see also comments above. It is helpful to investors to quantify or monetise outcomes where possible.

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

We recognize that this will be particularly challenging for conglomerates that have completely different business models operating across the group.

Additionally, we would suggest including within 4.22 the concept of systemic risks created by the actions of the organisation and its industry. This is an important component of the idea of a sustainable and resilient business model.

Other

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

We would recommend re-focusing the description of “value creation” away from the capitals and onto the stakeholders that an organisation intends to create value for. An integrated report needs to help a user understand how value is defined by customers, employees, etc... the definition of “value” is not only up to the company.

The section on “value for providers of financial capital” (paragraphs 2.38-2.40) and the section on “the meaning of value” should make explicit and repeated references to the concept of “risk”. Investors are primarily interested in “risk-adjusted financial returns”. An insight into the creation or destruction of other capitals and/or for other stakeholders can provide useful insight into the risks to future financial returns. At the moment there is no mention of risk.

Paragraph 2.42 should make it clear that the primary intended user of an Integrated Report is providers of financial capital.

Paragraph 2.45, third bullet: it would be better to refer to “corporate culture” rather than “values”. Corporate values are one component of corporate culture.

Chapter 3: Guiding Principles

Materiality and conciseness (Section 3D)

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

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

We agree that materiality should be driven by the assessments of investors as the primary intended report users. However, the concept of materiality is complex and goes well beyond the popular but incomplete perception that it must be related to a big number. It will sometimes be a qualitative assessment and about judgement.

Specifically the ICGN's Statement on Non-financial Business Reporting (2008) states that: "Non-financial business reporting is material if it might reasonably be expected to affect investors' decisions about the acquisition and sale of shares or the exercise of ownership rights and obligations."

Issuers cannot be put in conflict with their existing regulatory obligations with regard to materiality. Therefore the IR framework has to be flexible enough to accommodate statutory obligations regarding materiality in different jurisdictions.

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

We strongly agree with the need for conciseness set out in para 3.29 and the reduction of clutter. Integrated reporting should not be about the wild profusion of unmanageable data. We would note, however, that an investors' willingness to accept concise disclosures is directly related to the level of trust in the reporting entity. Trust can be improved by providing both positive and negative information; by describing the rationale and process for deciding what information has been included and left out; a clear indication of where additional information can be obtained; and, in general, openness and receptivity to dialogue with investors.

Reliability and completeness (Section 3E)

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

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

We agree with para 3.30 that an integrated report should include all material matters, both negative and positive, in a balanced way free from material error. We feel that reports should give a true and fair view. Transparent disclosure will help to demonstrate this whilst boilerplate disclosure will give much less comfort. Robust assurance will help provide credibility in this respect. See also comments below in relation to credibility (section 5E).

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

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Other

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

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Chapter 4: Content Elements

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

We wish to add 'competence and experience' to diversity and skills of those charged with governance (4.11) because it is about adding value to the Board.

Management remuneration should reflect a holistic view of the company and an approach to managing risk and creating value.

Chapter 5: Preparation and presentation

Involvement of those charged with governance (Section 5D)

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

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

Yes. Accountability should be at the core of all reporting. As its title suggests, ICGN's core aim is to promote best practice in governance. Management must account for their stewardship and this starts with a fundamental acknowledgement of their responsibility. Para 5.17 sets out the rationale well. It would be helpful to acknowledge the primacy of investors in this reporting relationship.

We would expect those charged with governance to provide a statement of compliance with the IR framework. In our view this should be mandatory. Moreover, we would expect the external auditor to perform a consistency check also for the Integrated Report.

(Non-executive) Directors should state explicitly that they have not only ascertained the reliability and completeness of the financial numbers but also of the content of the Integrated Report. There are examples of such requirements already in some jurisdictions such as Australia (Section 299A of the Corporations Act).

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

Credibility (Section 5E)

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

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

Assurance is essential in providing credibility to reporting. In principle, assurance should cover the entire report but this may be unrealistic in the earlier phases. Both assurance and underlying metrics for the different capitals are still evolving and assurance providers will need to invest heavily in building up rigorous testing techniques. We welcome assurance providers' comments on this.

Other forms of assurance can also be valuable, for example the aforementioned statement by Non-executive Directors on the whole Integrated Report or assurance by multi-stakeholder associations. 20. Please provide any other comments you have about Credibility (Section 5E). Assurance providers are particularly asked to comment on whether they consider the Framework provides suitable criteria for an assurance engagement.

We note the distinction between setting the framework for integrated reporting against which assurers need to assess reports on the one hand and the protocol for performing audit engagements. This division of labour between standard setters and auditing standards bodies has been generally helpful in financial accounting. However in order for it to work there needs to be effective dialogue and co-operation between the parties.

The true and fair view used in financial accounting audit may be helpful in integrated reporting as it seeks to test whether the financial statements adhere to the principle as well as the letter. Clearly the users of integrated reports want to be satisfied that they go beyond bare compliance with the rules.

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

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Overall view

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

As companies produce integrated reports the feedback will provide valuable insights into how the framework should evolve. We certainly expect it to be work in progress for some time.

Development of <IR>

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

- Linkages between the IR Framework and existing disclosure framework
- Database of good practice examples, not necessarily full reports but components/ sections thereof
- Expected involvement of the Board in the process of integrated reporting

Other

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

With regard to paragraph 1.1.2 on page 8 we wish to highlight that the requirement to indicate what information has been omitted and why can be in breach of regulations. Any explanations should be limited to material information.