

ANALYSIS OF FRAMEWORK

CHAPTER 2: FUNDAMENTAL CONCEPTS - OTHER

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

NOTE: This objective analysis includes only the most prevalent, significant or controversial issues as far as they relate directly to the content of the Consultation Draft of the International <IR> Framework¹, for the attention of the Working Group and therefore not all matters raised in submissions are referenced in it.

Drafting this analysis involved considerable judgment in deciding how to categories comments into issues/themes and how to summaries the underlying positions. Statistics have been included to provide a snapshot and starting point for analysis. Although the statistics indicate the prevalence of different views, due consideration will be given to the substance of all positions expressed.

In total the IIRC received 359 submissions to the Consultation Draft. 352 are included in this analysis. The remaining 7 submissions (of which 6 were late and one was in too complex for collation) are being reviewed separately.

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A – OVERVIEW

- A1 Question 10 was about other comments in relation to fundamental concepts not covered by questions 5-9 on the capitals and business model. Respondents were not asked to state agreement or disagreement with a statement, as a result a range of issues were raised.

- A2 There were 147 responses to question 10. They were in relation to the following items, some covering more than one area:
 - Chapter 2 Fundamental concepts, 24 comments mainly in relation to content, structure and order
 - Section 2A Introduction, 18 comments primarily being proposed amendments to paragraphs in this section
 - Section 2B The capitals, 8 comments (these comments have been analysed in the paper on questions 5-6)
 - Section 2C Business model, 19 comments (these comments have been analysed in the paper on questions 7-9)
 - Section 2D Value creation, 101 comments on definition, the audience for <IR> in relation to value creation and measurement, and further comments on application of the Draft Framework.

- A3 Over 10% of these responses included proposed amendments to words or phrases in the Draft Framework. These have been separately captured for review by the IIRC staff.

¹ <http://www.theiirc.org/consultationdraft2013/>.

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B – CHAPTER 2 FUNDAMENTAL CONCEPTS

- B1 A range of comments about the Draft Framework itself, its content, structure and the order of content were expressed in question 10. This paper only includes those that are specific to Chapter 2 Fundamental concepts and the sections within it. Of the 147 responses to this question 24 made comments in relation to these items.
- B2 With regard to the content, structure and order of this chapter the following key points were raised:
- a few comments about lack of clarity regarding the purpose of this chapter, illustrated by:
 - "We note that Chapter 2 Fundamental Concepts, which we believe to be the most important part of the Framework, does not contain any words in bold italic type, which raises question as to whether it might be perceived to be subsidiary to the wording in bold italic type." (Ernst & Young Global Limited)
 - "Chapter 2 does not give any reporting requirements. What is the goal of this chapter?" (Royal HaskoningDHV)
 - a few viewed Chapter 2 as theoretical and detailed, suggested ideas included "to favor a more practical approach, the Chapter 2 could be placed in appendices" (CAPITALCOM) or summarise it and present the detail in another document
 - a few comments stating <IR> is about innovation and that this concept is not emphasised enough "innovation should play a more critical role in it as it is considered key for creating value on the long term" (Benelux Pilot Programme participants)
 - one response raised the importance of further strengthening the emphasis of flexibility in this chapter because 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" (Insight ResponsAbility)
 - some comments were raised about the order of the fundamental concepts, including:
 - "value creation is a core concept which needs to be one of the first aspects [...] essentially we would recommend lifting its importance by putting it right up front with the discussion of the definition of a business model and the inputs/outputs of capitals" (Threadneedle Investments)
 - "the logical sequence is the initial emphasis on business model, its relation to capital and how the company creates and maximizes value" (TheMediaGroup)
 - there were numerous comments about duplication between business model as a fundamental concept and a content element, illustrated by:
 - "the 'fundamentals concepts' and the 'content elements' are somehow 'overlapped'. We do not see the need to keep 'business model' as a 'fundamental concept'" (Indra).

C – SECTION 2A INTRODUCTION

- C1 Section 2A Introduction is introductory text that seeks to put discussion of the capitals, business model and value creation into an overall context. Of the 147 responses to this question 18 specifically commented on Section 2A Introduction, excluding comments in relation to the figures presented within this section, which are included later in this paper.
- C2 Over half of the submissions that commented on this Section included amendments to text in Section 2A, primarily to clarify or better emphasize the text or its meaning.
- C3 In relation to the section as a whole there were comments which asked for:
- increased emphasis on business model and that it can destroy value
 - increased emphasis on how risks are managed including "how they deal with risks and where they have failed" (Jones Lang LaSalle)
 - expanding on the external environment in Chapter 2, which is discussed in detail in paragraphs 4.8 and 4.9 in the Draft Framework, because it "is integral to a company's value creation process" (Potash Corporation of Saskatchewan Inc.).

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- C4 Comments on specific paragraphs included:
- explanation of the terms 'elements' and 'dynamic flux' in paragraph 2.6 in a couple of submissions
 - "... the intent and implications of paragraph 2.9 might be more clear to the preparers of integrated reports if it were to include a reference to section 5G on Reporting boundary." (AICPA)

D – FIGURE 2 AND FIGURE 3

- D1 The diagrams in Section 2A of the Draft Framework are:
- Figure 2: "An organization interacts with its external environment and uses and affects the capitals to create value over the short, medium and long term" (commonly known as "the octopus")
 - Figure 3: "The complete picture of an organization's value creation process, showing the interaction of the Content Elements and the capitals in the context of the organization's external environment" (commonly known as "the expanded octopus")
- D2 Of the 147 responses to this question 9 specifically commented on Figure 2 and/or Figure 3. A few responses specifically supported the inclusion of the diagrams, for example "... Figure 3 [...] is an excellent tool for an organisation seeking to ensure that it covers all aspects of its value creation proposition in its integrated report" (Deloitte Touche Tohmatsu Limited).
- D3 Opportunities for improvement in relation to these diagrams were:
- the figures need a concise suitable name rather than a description, for example 'value creation model'
 - concise narrative is needed to explain what the models communicate, this is viewed as not being presented or being too lengthy in Chapter 2 as a whole.
- D4 Comments on the presentation of the diagrams included the following.

Figure 2 only	Figure 2 and figure 3	Figure 3 only
<p>"Difference and relations are unclear between external environment and capital" (Japanese Ministry of Economy, Trade and Industry)</p> <p><i># NFA – this seem clear enough</i></p>	<p>"It would be clearer if the business model diagram were to articulate where the value is created." (World Intellectual Capital Initiative (WICI))</p> <p><i># Suggest we emphasise the wording in the middle of Fig 2 and call the diagrams "value creation model"</i></p> <p>"... [to] alter the figure denote the value creation in the form of environmental friendliness, financial stability and social responsibility. (CA Rajkumar S Adukia, Individual)"</p> <p><i># Suggest we emphasise the wording in the middle of Fig 2 and call the diagrams "value creation model"</i></p>	<p>"The octopus model shows capitals coming out of the internal governance, but the external governance and the company's stakeholders are not represented here." (DNV Two Tomorrows Limited)</p> <p><i># NFA – these are better left to the explanation of value creation</i></p> <p>"... evaluating an outcome (separately) for each different capital is not appropriate." (Japanese Ministry of Economy, Trade and Industry)</p> <p><i># NFA – external governance is covered by external envn't; and stakeholders is covered by capitals and external envn't</i></p> <p>"Section 2D refers to "value drivers" (paragraph 2.45) but this concept is not shown in Figure 3 (the complete picture of an organisation's value creation process)." (Deloitte Touche Tohmatsu Limited)</p> <p><i># Suggest we delete value drivers in para 2.45 – see below at para E9</i></p>

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E – SECTION 2D VALUE CREATION

- E1 Of the 147 responses to this question over two thirds (101) commented on the content of Section 2D Value creation. No specific question was asked on this fundamental concept so submissions were not asked to state agreement or disagreement with a statement. Due to the nature of the question asking for 'any other comments' a range of issues were raised. All statistics in the remainder of this section are based on the sub-population of 101 respondents.
- E2 There were 15 respondents who specifically expressed support for the concepts of value and value creation, and numerous others who expressed support for content within this section. However, over half the respondents (61) requested clearer definitions or clarification of content in this section, of which 45 specifically commented on the terms and concepts of value and/or value creation.

SUPPORT FOR SECTION 2D VALUE CREATION

- E3 There was support for the concept of value creation and paragraphs within this section in 22 submissions, covering all geographic areas and across stakeholder groups including report prepares and providers of financial capital. Notable comments which illustrate this support included:
- "There is public demand that reporting responds to the challenge by building a bridge between the businesses and the investors and incentivizing them to act in a long-term oriented way. We believe that the fundamental policy of the Consultation Draft, <IR> communicates the sustainable value created by an organization over time, meets the primary and fundamental objective." (The Japanese Institute of Certified Public Accountants (JICPA))
 - "economic, environmental and social returns contribute to company value, and therefore we are strongly supportive of measures to enhance disclosure of how these risks and opportunities are being managed" (Australian Council of Superannuation Investors)
 - "great potential to enhance stewardship and accountability for the longer term, within the public sector" (Wales Audit Office)
 - "The section on Value Creation (2D) is both thoughtful and thought-provoking. It is also central to understanding many of the guiding principles in section 3." (International Council on Mining & Metals).

DEFINITION OF VALUE AND VALUE CREATION

- E4 Sixty-one submissions requested definition or clarification of content, of which 45 asked for this in relation to the concept(s) of value and/or value creation.
- E5 From these responses clear themes were identified as follows:
- what is value?
 - value needs to be defined in the Draft Framework before value creation is communicated
 - what is value creation?
 - the definitions of value and value creation should not make reference to the capitals given that paragraph 2.13 defines capitals as 'stores of value'
 - value for whom?
 - value is not just created, it needs to be preserved
 - where value creation is used the IIRC should always refer to value being destroyed as well.
- E6 The following responses demonstrate the need for definition and clarity in relation to value and value creation:
- "The framework does not include a definition of value. What does IR mean by value? Who defines value? For whom is the value created? Since value creation is at the heart of the framework, one would think some clarity around value or at least a definition would be included." (Teck Resources Limited)
 - "Value Creation is highly subjective an[d] a detailed guidance document is needed. Paragraph 2.42 is particularly confusing." (Confederation on Indian Industry - Centre of Excellence for Sustainable Development and also WBCSD and Local BCSD - India)

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- "This definition [in paragraph 2.41] does not elaborate on the 'other forms of value' and how they relate to the capitals." (UNGC)
- E7 Numerous suggestions for the definition or how to clarify the meaning of value and/or value creation were made, although there was no clear consensus about which approach is best. The range of ideas reflected in responses included:
- "'Value Creation' is a very difficult expression. As for business including accountants, "Cash Flow" is much more appropriate and easy to understand." (NKSJ Holdings)
 - "... whilst there will be trade offs and impacts arising from a company's use of the capitals, value creation should focus on financial capital whilst acknowledging and explaining these various trade offs" (Standard Life Investments)
 - "... most investors also include extrafinancial aspects in their definition of value" (Natixis Asset Management)
 - "... value creation for infrastructure, the market economies, where a company has business activities (i.e. corporate governance issues) and for the stability of the business environment should be added, as they empower the licence to operate in those regions and abroad." (German Council for Sustainable Development - Advisory body of German Federal Government)
 - "... a clear distinction should be drawn between reporting on matters affecting shareholder value (as represented by the value of future returns the business is expected to generate), and reporting on stakeholder value creation. Information on stakeholder value creation may be relevant in an Integrated Report to the extent that it enables report users to assess the ability of the business to create shareholder value, but otherwise may not be relevant." (KPMG)
- E8 In the absence of definitions, or as an alternative to providing them, 5 responses suggested a definition where value and/or value creation be defined either by the organization itself or by its stakeholders:
- "It might be a good idea to force companies to articulate what "value" means to them within the broader <IR> context." (PricewaterhouseCoopers, North America)
 - "In the absence of a clear definition, then the framework should make a requirement that the organization articulates how it defines value, and value to whom." (Vancity)
 - "... re-focusing the description of "value creation" away from the capitals and onto the stakeholders for which an organisation intends to create value. An integrated report that provides a clear understanding of the business model 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. " (Hermes EOS Ltd) (BT Pension Scheme) (APG Asset Management)
- E9 Eleven submissions challenged, or requested definitions, clarification or examples of value drivers, as discussed in paragraph 2.45, the majority of these comments were from professional bodies – accounting or assurance providers. Only a couple of submissions specifically supported this paragraph and about half included suggested amendments to the examples given in this paragraph. The recurrent message in these responses was:
- "Value drivers (2.45) appear as a new concept at the end, and seem to be disconnected from capital changes, outcomes, etc." (Asociación Española de Contabilidad y Administración de Empresas)
 - "'Value driver' fails to provide its definition and is hard to place in this Framework. The given examples, either mixes up causes and effects (the first example), lacks clarity in its relations with capital (the second example), or, includes value in itself (the third example). 'Value driver' in the current form, is a concept difficult to be included in this Framework." (Japanese Ministry of Economy, Trade and Industry)
- E10 A few respondents asked for a definition or clarification in relation, to value for providers of financial capital, of "planetary limits", as used in paragraphs 2.39 and 2.40.

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AUDIENCE FOR <IR> IN RELATION TO VALUE CREATION

- E11 There were 27 responses that made clear reference to the audience for <IR> in the context of value creation. There were also 15 responses specifically on the concept of value creation from providers of financial capital and analysts, 9 of which specifically commented on audience (included in the 27 above), including one response reflecting the views of eight asset owners from around the world.
- E12 Four responses representing a total of 11 asset owners said "investors ultimately look for a satisfactory return on their financial capital". This theme was also expressed by several other providers of financial capital and others respondents, as well as numerous comments reflecting a clear need for information relevant to "risk-adjusted financial returns" to be provided in an integrated report.
- E13 These four responses also stated "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". They continue that the concept of the capitals "... is helpful in illustrating the broad sources of value that may underpin the financial performance of companies. We agree that other forms of capital [...] can have a significant effect on the ability of a company to sustain value over time".
- E14 In the 15 responses from providers of financial capital and analysts, further comments put investors' own interest in 'risk-adjusted financial returns' into context, that return on financial capital is dependent on other factors, illustrated by "financial returns can only happen where there is value creation for all stakeholders" (Natixis Asset Management). The reason for needing information that is not financial is shown in these two quotes:
- "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." (Hermes EOS Ltd)
 - "in order to understand the financial capital performance / prospects of the business it is necessary to under[stand] the roles of other capitals and to respond to the risks and opportunities created by a range of material stakeholders" (JP Morgan)
- E15 Of the 27 responses which made clear reference to the audience for <IR> in the context of value creation:
- over half (14) supported value being for providers of financial capital, including half which were providers of financial capital or analysts (representing responses from 14 organizations), and 3 which were responses from report preparers (representing responses from 9 organizations), illustrated by:
 - "To the extent that an Integrated Report is intended to be an investor-focussed corporate communication, we think that the application of the concept of value equally to all capitals might deflect the focus of the Integrated Report from being solely on the needs of investors. We are concerned that this might result in the Integrated Report being an unnecessarily lengthy document which does not efficiently meet the needs of investors, or those of wider stakeholder groups." (The Financial Reporting Council)
 - "long-term investors care for non-financial capitals such as intangibles or natural capitals is because those have strongly affected the company's ability to create long-term financial/economic value, and therefore, long term risk-return profile" (The Japan Research Institute, Limited)
 - 10 (mostly report preparers and professional bodies) called for a stakeholder inclusive approach, illustrated by:
 - "value for IR purpose[s] encompasses other forms of value that the entity creates. However, when reading through the framework, and the fact that the framework states that the report should be aimed at providers of financial capital; it seems to always come back to financial capital – it creates a perception of contradiction within the framework." (Eskom Holdings SOC Limited)
 - "the Framework seems to focus on the value the organisations bring to itself (or the financial capital providers) and has not deliberated on what values the organizations brought to the holders of the organisations' social license to operation (i.e. society and their immediate community)." (Accountant and Appraiser Supervisory Center – Ministry of Finance of Republik Indonesia)
 - three reflected that the position of the Draft Framework was confusing.

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- E16 It was clear that many respondents cannot reconcile stakeholder responsiveness in relation to a document whose primary audience is providers of financial capital, indicating that the Draft Framework is not clear enough on this critical concept. This is demonstrated by the following response in relation to the first bullet point in paragraph 2.37 (which says "An organization can create and maximize value by serving the interests of, and working with, all its key stakeholders, such as employees, customers, suppliers, business partners, local communities, legislators, regulators, and policy-makers...): "... this statement may not always be true - trying to serve the interests of all stakeholders simultaneously is unlikely to happen in practice." (Ernst & Young Global Limited)
- E17 There were also numerous respondents that were not clear how more than one stakeholder group can be the user of the same report, illustrated by:
- "the Framework states that <IR> provides value for providers of financial capital and that other stakeholders are likely to benefit from the information in an integrated report. It is unclear how other stakeholders would benefit from a report focused on providers of financial capital." (US SIF)
- E18 In order to address these concerns a few suggestions have been made to better articulate the intention of the Framework, illustrated by this example with reference to paragraph 2.38 (which says: "Providers of financial capital are focused on value in the form of financial returns. Those returns are, however, dependent on inter-relationships between various types of capital in which other stakeholders have an interest. Therefore, other stakeholders are also likely to benefit from the information in an integrated report"):
- "this paragraph could better explain how providers of financial capital are also, or should also be, interested in the return on other capitals, as their returns on financial capital are directly dependent on them. Another paragraph could be used to emphasize the separate point that other stakeholders might also have an interest in the interrelationships between the various capitals." (IFAC)
- E19 A small number of responses acknowledged that the difference in opinions may be time related and not a permanent barrier, acknowledging there is scope for clarity on this matter:
- "Long term value aligns interests of finance providers and society, but these interests are less aligned in the short and medium term." (World Intellectual Capital Initiative - Europe)
 - "differences in the perception of value between categories of stakeholder are likely to reduce or even converge over a longer time horizon as all have an interest in a company demonstrating the ability to manage all relevant capital stocks in the long term to avoid depletion" (PricewaterhouseCoopers International Limited).

MEASUREMENT OF VALUE AND/OR VALUE CREATION

- E20 Twenty submissions commented on the topic of measurement, nearly all of which requested a clearer definition or clarification of the Draft Framework or raised concern about the content on this topic, and the majority of these comments specifically focused on non-financial aspects of measurement.
- E20 Twenty submissions commented on the topic of measurement, nearly all of which requested a clearer definition or clarification of the Draft Framework or raised concern about the content on this topic, and the majority of these comments specifically focused on non-financial aspects of measurement.
- E21 Some of the responses identified challenges in relation to measurement and some included views on how to measure value and/or value creation:
- "Value created in the form of financial returns to providers of financial capital [...] is a familiar concept, but qualifying it in the form of 'positive or negative effects on other capitals and other stakeholders' introduces a degree of subjectivity which is virtually impossible to quantify." (HSBC)
 - "If value creation is dependent on other capitals, as the framework claims, then paragraph 2.42 should more clearly explain why <IR> is not requiring value measurement for each capital." (IAAER)
 - "Section 2D does not take into account the difficulties of measuring non-financial value. It is highly likely that negative impacts on others will be undervalued." (International Trade Union Confederation and the Trade Union Advisory Committee to the OECD)

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- "the capitals section of the CD notes that some of the capitals would have different values depending on the perspective taken. As well, that section acknowledges that it would not be practical to expect organizations to attempt to quantify all uses of and effects on the capitals, apparently recognizing that in some circumstances there may be no reasonable way to value a capital." (CPA Canada).
- "measuring elements of value creation is essential and always practicable, at least on an ordinal scale (e.g. "more/less than last year") or, failing that, on a nominal scale under measurement theory (classification of different kinds of outcomes or in-puts)" (IdW - Institut der Wirtschaftspruefer in Deutschland)

APPLICATION OF SECTION 2D VALUE CREATION

- E22 A range of comments were made across stakeholder groups in relation to issues around the application of Section 2D. These included the following items, most of which were raised in a few submissions:
- "What is exactly short, medium and long term? Is this a concept linked to time or to the industry or to the business model of an organisation?" (World Intellectual Capital Initiative – Europe)
 - "The role of effective, responsible leadership (as the foundation for good governance) is fundamental to an organisation's short, medium and long-term viability and its ability to sustain value creation, and hence is relevant for disclosure in the report." (Integrated Reporting Committee, South Africa)
 - "We do not think IFRS provides a credible basis for predicting future value." We support the approach "...which calls for companies, under safe harbour provisions, to publish their projected cash flows, profit forecasts and balance sheets based on their latest audited balance sheets and business models. This would ensure that where cash flows do not materialise, ineffective accounting would be evident. " (Local Authority Pension Fund Forum)
 - in relation to public sector application "emphasis on 'value over time' is particularly relevant" (Wales Audit Office) and in relation to paragraph 2.37 "This implies that creating and maximizing value always manifests itself in positive financial returns but positive or negative returns for the providers of other forms of capital. Many public sector or not-for-profit entities, however, maximize value with a negative effect to providers of financial capital." (IFAC).