

**Assurance on Integrated Reporting <IR>**  
**An Introduction to the Discussion**

28<sup>th</sup> November 2014

Dear IIRC members,

I fully agree that assurance on <IR> is likely to be important for the long term credibility of integrated reports and I welcome this initiative to help address this challenge.

Please find attached my comments in relation to assurance on <IR> which are in the form of two appendices.

**Appendix I:** General Observations

**Appendix II:** Response to Specific Questions

I would like to thank the IIRC for providing this opportunity to comment on the consultation draft. Should you require any additional information or wish to discuss any of the issues raised in more detail please do not hesitate to contact me.

Yours sincerely

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## APPENDIX I

### GENERAL OBSERVATIONS

#### A. Continuing To Foster The Creation Of An Integrated Perspective

The IIRC has stated that Integrated Reporting <IR> is a process founded on integrated thinking, and that integrated thinking involves the active consideration of various relationships within the organization leading to integrated decision making and actions. Integrated thinking is therefore fundamental to <IR><sup>1</sup> and the promotion of integrated thinking is essential to the <IR> process. Integrated thinking requires a holistic view of the organization and demands a comprehensive understanding of the breadth and depth of its activities in order to be in a position to form as complete a picture as possible. In relation to <IR> in order to help foster stability and sustainability it should involve a holistic vision of how an organization is addressing the overarching business objective of delivering long term sustainable value.

In my opinion the nature of sustainable value and the objective of delivering sustainable value to stakeholders in the long term demands a subtle blending of both value creation (offense) and value preservation (defense) efforts. 21<sup>st</sup> century business requires an integration of both offense and defense at all levels (both internal and external to the organizations themselves) in order to help maximize both value creation and value preservation (thereby making it more likely to deliver sustainable value to stakeholders in the long term). The <IR> framework adequately addresses the value creation imperative however in my opinion the value preservation imperative requires additional explanation and guidance.<sup>2</sup>

The value preservation imperative should be actively considered from an integrated perspective. In this regard the value preservation imperative represents the measures (formal or otherwise) taken by an organization to defend itself and the interests of its stakeholders from a multitude of potential hazards (risks, threats, and vulnerabilities), the occurrence of which could be detrimental to the achievement of the organization's objectives. Successful self-defense requires managing all of the following inter-connected and inter-dependent critical value preservation systems in an integrated manner.

**Governance:** How the organization is directed and controlled, all the way from the boardroom to the shop floor.

**Risk:** How the organization identifies, measures, and manages the risks it is exposed to.

**Compliance:** How the organization ensures that its activities are in conformance with all relevant mandatory and voluntary requirements.

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<sup>1</sup> For more detail please refer to my comments on "Integrated Thinking" in my previous response to the IIRC consultation draft April 2013, Integrated Reporting – International Framework

<sup>2</sup> The final version of the IIRC's International <IR> Framework does at least now include reference to the notion of value preservation in its depiction of the "Value Creation Process" (Fig 2, Page 13).

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**Intelligence:** How the organization ensures that it gets the right information, in the right format, to the right person, in the right place, at the right time.

**Security:** How the organization ensures it protects its critical assets (tangible and intangible) from threats and danger. Examples of critical assets include people, information, technology, and facilities.

**Resilience:** How the organization ensures that it has the capacity to withstand, rebound, or recover from the direct and indirect consequence of a shock, disturbance, or disruption.

**Controls:** How the organization ensures that it has taken appropriate actions in order to address risk and to help ensure the achievement of its objectives.

**Assurance:** How the organization provides a degree of confidence or level of comfort to its stakeholders that it is operating in a satisfactory manner.

An integrated defense program should be designed to help ensure that the organization's value preservation systems are in alignment with and actually reinforce corporate strategy in order to maximize their added value. In the process, it should provide an appropriate system of checks and balances to help ensure that an organization's defense related activities are strategically aligned, tactically integrated, and operating in unison towards common objectives. The introduction of such a formal systematic defense program can help an organization arrive at balanced, informed decisions and help support the achievement of business objectives, while also providing both defense-in-depth and defense-in-breadth.<sup>3</sup>

In order to help foster the creation of an integrated perspective I would suggest the following:

- The IIRC further consider the relationship between value creation and value preservation in the context of delivering long term sustainability and its potential impact on <IR>.
- The IIRC actively consider the value preservation imperative from an integrated perspective.
- The IIRC actively consider assurance as a component of value preservation which is inherently inter-dependent and inter-connected with the other value preservation components.

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<sup>3</sup> Please see my 2012 HBR/McKinsey M-Prize submission entitled "Achieving a Healthy Balance Between Offense and Defense in 21<sup>st</sup> Century Capitalism". <http://www.managementexchange.com/hack/achieving-healthy-balance-between-offense-and-defense-21st-century-capitalism>

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### **B. The Promotion Of An Integrated Approach To Assurance**

In addition to its relationships with other value preservation components the concept of assurance should in and of itself be addressed from an integrated perspective. Traditionally assurance has been required in order to help establish credibility, trust, and confidence among relevant stakeholders. This involves actively considering the notion or purpose of assurance from a broader stakeholder perspective both internal and external to the organization. It involves considering internal and external assurance providers above and beyond the traditional assurance providers of internal and external audit. It involves considering the latent potential of assurance providers and the adoption of an increasingly innovative approach to harnessing this potential.<sup>4</sup>

Integrated thinking involves identifying all possible assurance providers and considering the type of assurance each is capable of providing, while also considering their independence, objectivity, and impartiality. It involves consideration of the potential value of such assurance providers to stakeholders and in the process determining who the key assurance players are. Internally it involves systematically coordinating and aligning key assurance providers cross-functionally, inter-disciplinary, and hierarchically. An integrated approach to assurance should focus on helping to ensure positive collaboration and co-operation among assurance providers and facilitate interactive communication and better information sharing. It should involve determining the specific assurance roles and responsibilities of such key assurance providers, and establishing suitable mechanisms for holding them to account.

Integrated assurance should consider how the concept of assurance is understood and applied across an organization, at strategic, tactical, and operational levels. It should include consideration of the organization's strategic assurance objectives, its tactical assurance objectives, and its operational assurance objectives. It should consider the assurance strategy, the assurance framework, and the assurance practices required to help enable the provision of both vertical (top-down, bottom-up) assurance and horizontal (cross-functional) assurance. Such an undertaking should consider how best to help ensure that appropriate assurance processes and practices are integrated on an enterprise-wide basis in order to form part of the ongoing business process and become embedded into day-to-day operations so that it becomes part of the organization's DNA.

I would suggest that the IIRC consider this assurance initiative from an integrated perspective and consider the requirement to promote the adoption of an integrated approach to assurance. If integrated thinking has helped identify the requirement to progress to the provision of <IR> then it should similarly help identify the requirement to progress to the provision of integrated assurance over the <IR> process.

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<sup>4</sup> The Institute of Internal Auditor's concept of "Combined Assurance" already focuses on a holistic approach to organizational governance. See Sarens et al (2012), Combined Assurance: Case Studies on a Holistic Approach to Organizational Governance, The IIA Research Foundation 2012

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### C. An Integrated Assurance Program

An integrated assurance program should begin with an integrated assurance strategy outlining how the organization intends to achieve its strategic assurance objectives, which in turn should be in alignment with its business strategy and its strategic business objectives. Such a program should also include an integrated assurance framework which identifies the key assurance providers and outlines their roles and responsibilities in providing assurance at strategic, tactical, and operational levels.

For example, strategic assurance would involve the provision of assurance in relation to issues of a strategic nature such as the organization's strategic assurance objectives, its control environment and culture, and the existence and appropriateness of formal structured programs to address other defense components. Tactical assurance would involve the provision of assurance over the appropriateness of the assurance framework in place and the transparency over the roles, responsibilities, and accountabilities of the key assurance providers etc. Operational assurance would involve the provision of assurance over the operational effectiveness and efficiency of practices, processes, and procedures.

An integrated assurance framework should include a structured oversight element in order to help ensure that the key assurance providers are held to account for their assurance responsibilities. In this respect the five lines of defense oversight model can help provide the required assurance oversight as follows:<sup>5</sup>

1. **Operational Line Management** has responsibility for overseeing and providing assurance in relation to the daily operations of staff, services, practices, mechanisms, processes, and systems.
2. **Tactical Oversight Functions** have responsibility for overseeing and providing assurance in relation to the consistent, competent, adequate, and effective operation of defense activities established by operational line management. Examples include the compliance, risk management, and internal control functions.
3. **Independent Internal Assurance** provides the board with a level of independent assurance in relation to the effectiveness of the activities of the other lines of defense. Examples include the audit committee, risk committee and the internal audit function.
4. **Executive Management** provides assurance to the board that the objectives of the organization are being achieved by providing adequate oversight of those they manage and by ensuring that the organization's activities are consistent with business strategy and policies approved by the board.
5. **The Board** is responsible for overseeing the activities of the organization and is accountable to the shareholders for the organization's strategy and performance. This includes overseeing and providing assurance on the activities of its standing committees and executive management.

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<sup>5</sup> Please see short video entitled "CDM: A Multi-Dimensional Framework" which provides an overview of the workings of the five lines of corporate defense framework. It is available on-line at: <http://www.youtube.com/watch?v=vLoA8U0GZHI>

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With such a model it is essential that each line of defense recognizes that it has specific oversight and assurance responsibilities in relation to each of the critical corporate defense components. These responsibilities begin at the boardroom but run right through the organization all the way to the front line (1<sup>st</sup> line of defense). To operate effectively each line of defense must play its part both individually and collectively (the chain is only as strong as its weakest link) thereby fulfilling their oversight and assurance duties within a holistic framework.

An integrated assurance framework should also consider the roles and responsibilities of key external assurance providers and how they can add value to the assurance process. Examples of key external assurance providers include the following:<sup>6</sup>

- **External Auditors and Consultants:** The use of external professionals who are independent of the organization being reviewed can help provide an unbiased and independent evaluation of the subject matter under review.
- **Shareholders:** As owners of the organization shareholders, directly or through designated agents, have a responsibility to assess and monitor the effectiveness the board and have the opportunity to bring the board to task if they believe the performance of the board is in question.
- **Rating Agencies and Research Analysts:** Involves the use of independent professional organizations that specialize in analyzing, benchmarking, and rating organizations using their expertise in selected disciplines (e.g. credit, corporate governance, risk management etc).
- **Regulators:** Typically regulators are responsible for codifying and enforcing rules and regulations, and imposing supervision or oversight of a particular industry or service for the benefit of the public at large.

I would suggest that the IIRC consider what would be regarded as the key aspects of an integrated assurance program and the organizational requirements for introducing such a program. I would suggest that the existence of an integrated assurance program would positively impact on the <IR> process both directly and indirectly.

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<sup>6</sup> Please see my 2011 Conference Board paper entitle “Corporate Oversight and Stakeholder Lines of Defense”: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1938360](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1938360)

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### **D. The Provision Of Assurance In Relation To <IR>**

The information provided in the integrated report will form the basis of decision making by stakeholders and therefore its reliability is a critical issue in terms of establishing credibility, trust, and confidence. The reliability of the integrated report will be influenced by the manner in which the organization manages its critical value preservation systems and whether this reflects a structured formal approach or an unstructured informal approach. A more mature approach invariably helps to demonstrate the organization's commitment to address such matters in an appropriate manner.

The <IR> process itself should involve an objective and risk based approach whereby the <IR> objectives are clearly outlined and the risks associated with the failure to achieve these objectives is carefully identified and considered. Appropriate controls to mitigate these risks in order to help achieve the <IR> objectives should be carefully determined. The reliability of the <IR> process will be indirectly influenced by the organization's own internal control framework and also its control culture and control environment. It will be directly influenced by the system of controls in place over the <IR> process itself and in particular by the operation of the specific controls in place to address the integrity (validity, accuracy, and completeness) of the precise information reported. Clear <IR> assurance objectives need to be outlined in advance with particular reference to reporting on both value creation and value preservation activities.

The provision of assurance in relation to the <IR> process will therefore require an integrated perspective in terms of both the organization in general and assurance specifically related to the <IR> process, including the <IR> environment, people, processes, and technology. The level of assurance required at strategic, tactical and operational levels will need to be clearly determined in order to give comfort that related controls are operating in an effective and efficient manner.

Pragmatically the provision of independent external assurance will be required and this should be provided by the performance of an assurance review of the <IR> process by independent external third parties. Those charged with providing assurance over the <IR> process must exercise judgment as to the extent to which other assurance providers can be relied upon in relation to the <IR> process. Careful consideration should therefore be given to the capability and maturity of the organization's internal assurance framework in order to determine the precise level of comfort that can be taken from its key internal assurance providers. Stakeholders can take certain comfort from the various assurance declarations received from the organization's various internal lines of defense on the expectation that they have performed their oversight duties in a competent manner. Ultimately the extent to which the information provided in an integrated report can be considered to be reliable and complete needs to be clearly expressed within the report and clearly understood by relevant stakeholders.

Any such assurance will most likely need to address conformance with the IIRC's <IR> International Framework and the ongoing performance of the <IR> process. It is therefore likely that assurance will need to be provided in relation to the initial <IR>



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project set-up, and this will most likely require a review (internal audit and/or external 3<sup>rd</sup> party) of aspects of the design, testing, validation, authorization, and audit phases of the project. Ongoing assurance may also be required once the process is live in particular in relation to change management etc. This may include a blending of both specific continuous (continuous monitoring, warnings, alerts, red flags etc) and more general periodic assurance (daily, weekly, monthly, quarterly, semi-annually, annually etc) over various aspects of the report. More comprehensive assurance may be required in relation to the production of the annual <IR> report.

The provision of assurance is traditionally a formal evidence based process. In any given assurance assignment the level of assurance provided may vary from “No Assurance” to “Limited Assurance” to “Reasonable Assurance” to “Dependable Assurance” to “Complete Assurance” depending on the available evidence and a cost benefit analysis. Therefore it is likely that it will be easier to provide a higher level of assurance over historic quantitative information such as financials than with non-historic qualitative information such as non-financials, operational issues, or expression of opinions. This may also apply in relation to forward looking projections of both a quantitative and qualitative nature, whereby the required evidence may not be so easily available. Ultimately the level of definitive assurance provided over the <IR> process may therefore vary throughout the <IR> process and therefore for the purpose of clarity and comparability where there is a degree of uncertainty it may be preferable to express any assurance provided in terms of confidence percentiles wherever possible.

I would suggest that the IIRC consider the requirement to introduce an objective and risk based approach which is applied at strategic, tactical, and operational levels in order to provide robust assurance over the <IR> process. A formal integrated assurance approach to the <IR> process will further help to encourage integrated thinking in this regard.



## APPENDIX II

### RESPONSE TO SPECIFIC QUESTIONS

#### **1: What priority should be placed on assurance in the context of driving credibility and trust in <IR>?**

In my opinion the credibility and trust of the <IR> process is of the utmost importance. The provision of adequate and appropriate assurance in relation to the <IR> process is in turn the utmost priority in helping to establish credibility, trust and confidence in <IR>. Determining what precisely constitutes an adequate and appropriate level of assurance is therefore the critical issue which needs to be addressed by this initiative. It therefore needs to be considered as its overriding priority. At a time of increasing mistrust in corporate behavior if an appropriate level of assurance cannot be provided to the relevant stakeholders then it is extremely unlikely that they will accept and support the <IR> process as a credible solution to the challenge it seeks to address. Ultimately confidence and trust are essential if <IR> is to become embedded into mainstream business practice.

#### **Q2: What are the key features of assurance that will best suit the needs of users of integrated reports in years to come?**

Users' primary need for assurance over the <IR> process is to help establish credibility, trust, and confidence in the <IR> process. This need is likely to apply to the short, medium, and long term. In order to address this need for scrutiny of the <IR> process the assurance provided will need to be seen to be of certain quality and standard in order to give the required level of comfort to users. It will certainly need to be regarded as independent, objective, and impartial. It will need to provide assurance over the production of the integrated report in relation to the reliability of the information reported and the quality of the <IR> production process. It will need to provide assurance that the integrated report has been produced in accordance and conformance with the required <IR> framework and standards. It will need to provide assurance over the controls in place to help ensure the integrity (validity, accuracy, completeness) of information reported.

#### **Q3: Is the availability of suitably skilled and experienced assurance practitioners a problem in your jurisdiction, and if so what needs to be done, to remedy the situation?**

Currently most jurisdictions are required to provide assurance over their financial reporting and also have many professional organizations which provide other forms of assurance. Given that <IR> is a relatively new concept it is unlikely that many jurisdictions (bar perhaps South Africa) will have a supply of assurance practitioners with skills and experience specific to the <IR> process. In the short term it seems practical to expect assurance practitioners to provide assurance on <IR> to the same standard as

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would be expected of other assurance assignments. As the knowledge and experience of the professional assurance community evolves and develops over time more specific guidance and uniform standards can be developed.

### **Q4: What needs to be done, and by whom, to ensure the quality of assurance on <IR> is maintained at a high level, including practitioners' adherence to suitable educational, ethical (including independence), quality control and performance standards?**

Initially the onus will be on the professional firms providing this assurance to meet the generally expected standards which apply to the provision of assurance services. In this regard the IAASB guidance could be considered the benchmark in the short term. The local regulators also have an important role to play in relation to regulating these assurance provision firms. As <IR> evolves over time guidance and standards need to be produced to specifically address the <IR> process and this will enable specific education, training, and certifications etc in relation to <IR> going forward. In my opinion the development of specific <IR> guidance, best practices and standards should be undertaken by the IIRC in collaboration with the relevant assurance providers' representative bodies (e.g. IAASB, IIA, etc). Regulator oversight of <IR> would also have a positive impact on the quality of the <IR> and the quality of the <IR> assurance provided.

### **Q5: Is the robustness of internal systems a problem, and if so what needs to be done, and by whom, to remedy the situation?**

The robustness of internal systems will certainly impact on the <IR> process either directly or indirectly. Of particular interest should be how an organization manages its value preservation systems on an enterprise-wide basis (e.g. governance, risk, compliance, intelligence, security, resilience, controls, and assurance). The more formal the approach, the more an organization can demonstrate a commitment to managing these activities in an appropriate manner. <IR> assurance providers will need to consider the maturity and capability of the organization's internal systems and the potential impact this is likely to have on the <IR> process itself.

### **Q6: Is assurance likely to be a cost effective mechanism to ensure credibility and trust over (a) the short/medium term; (b) the long term?**

Assurance is a necessary mechanism to help ensure credibility and trust over the short, medium and long term. The level of assurance required will no doubt be subject to a cost benefit analysis however the adoption of an integrated approach to <IR> assurance should allow the flexibility to provide this assurance at a number of different levels subject to perceived requirements. The level of assurance required to be provided may also vary over time. The important issue is to clearly outline to the users the precise level

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of assurance actually being provided. If the level of assurance provided is less than the level expected by stakeholders then this most likely will undermine the credibility of the <IR> process. The cost associated with the provision of <IR> assurance will also be influenced by stakeholder expectation and market forces (demand and supply).

### **Q7: If so, what needs to be done, and by whom, to maximize the net benefits of assurance?**

Initially there may be an opportunity for organizations to distinguish themselves from their competition not only through the integrated report itself but also by the level of <IR> assurance accompanying the integrated report. Market forces may well determine the net benefits of providing <IR> assurance and organizations may need to react accordingly. While initially <IR> is a voluntary requirement in the medium to long term it may be preferable that <IR> is eventually a mandatory requirement. It would be important for regulators to mandate the requirement for <IR> and to include the <IR> process in their oversight of the organizations concerned. It would also be important that rating agencies also include the <IR> process in its ratings of organizations and may even go as far as rating organizations on the basis of their integrated report.

### **Q8: Should assurance standard setters develop either or both (a) a new assurance standard; (b) guidance, to ensure consistency of approach to such issues?**

I believe that in the medium to long term both <IR> assurance guidance and standards should be developed. This will be required in order to help ensure greater consistency and comparability. Guidance and standards should be based on the evolving development of the <IR> process and the issues experienced which require additional guidance and clarification. In reality any such guidance should involve the IIRC as the champion for <IR> in collaboration with other relevant assurance standard setters in order to help maximize the benefits of any guidance or standards.

### **Q9: Should any such standard/guidance be specific to <IR>, or should it cover topics that are also relevant to other forms of reporting and assurance, e.g., should a standard/guidance on assuring narrative information, either in an integrated report or elsewhere, be developed?**

General assurance guidance and standards are already available from assurance standard setters such as the IAASB and the IIA. If <IR> is to succeed in its objectives then additional specific guidance and standards on <IR> assurance needs to be available, particularly in relation the provision of soft assurance on narrative and forward looking information. Any such guidance and standards should look to build on existing general assurance guidance and standards where possible, rather than re-inventing the wheel.

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**Q10: What are the (a) key challenges and (b) proposed approaches that assurance standard setters should consider with respect to:**

- **Materiality?**
- **The reporting boundary?**
- **Connectivity?**
- **Completeness?**
- **Narrative reporting and future-oriented information?**

(a) I would envision that the key challenge with respect to any/all of the above will be reaching a common international consensus. This may prove difficult as a result of differences between international cultures, market maturity, regional capabilities and other issues where individual regulators may have different requirements. Unfortunately this can result in misalignments and inconsistencies rather than uniformity and consistency.

(b) Any international standard will need to be developed and agreed over time. The gradual standardization of <IR> across different jurisdiction will be an evolving process. Initially it may be prudent to encourage regulators and policy makers to set their standards on these issues, as currently occurs in relation to financial reporting. As time goes by governments, regulators, and policy makers should be encouraged to adopt and mandate conformance with an agreed international standard while perhaps retaining the right to amend certain aspects as they see fit in relation to their own unique jurisdiction.

**Q11: What other technical issues, if any, specific to <IR> should be addressed by assurance standard setters?**

Assurance standard setters should address the requirement to express assurance based on levels of confidence rather than the single point figures preferred by accountants or vague wordings often used by some business consultants. Scientists and engineers prefer to speak in terms of likely variances and margins for error, and tend to express this by way of levels of confidence or confidence percentiles. In dealing with matters of uncertainty of outcomes it would be helpful to users if assurance providers were encouraged to measure the probability of both financial and non-financial outcomes and were able to provide assurance in terms of confidence levels and outcome distributions associated with both the quantitative and qualitative information reported.<sup>7</sup> Where information is being presented in the integrated report, the more precise and concise the information the better. Additional relevant information pertaining to uncertainty and confidence levels should help to better frame the information presented rather than being accepted as given.

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<sup>7</sup> For more information please refer to “Creating value through governance – towards a new accountability”, ACCA 2014, (Confidence in measures, page 30)

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**Q12: What are the (a) key challenges and (b) proposed approaches that assurance standard setters should consider with respect to:**

- Reasonable assurance?
- Limited assurance?
- Hybrid engagements?
- Agreed-upon procedures engagements?
- Other approaches?

(a) The level of assurance provided may differ depending on the breadth and depth of the assurance engagement. I believe that there needs to be a consistency in relation to the level of assurance expressed so that there is a degree of comparability within jurisdictions and internationally. The important point being that users are aware of the level of assurance being provided, that they can rely on this assurance and that it is comparable with other assurance provided in relation to <IR> for other organizations.

(b) An integrated assurance approach would facilitate different types of assurance engagements and potentially maximize the use of currently available assurance within the integrated assurance framework. Expressing assurance in terms of confidence levels and outcomes distributions will also help in relation to consistency of assurance provided.

**Q13: What are the (a) key challenges and (b) proposed approaches that should be considered and by whom, to ensure assurance on <IR> pays due regard to other assurance processes?**

(a) Where assurance providers operate in isolation or silo type structures a situation may develop whereby they are not in alignment, there is little or no interaction or sharing of information, and little cross-functional support. In some cases this may also develop into power struggles. This can result in confusion, overlap, duplication of effort, and unnecessary redundancy. In extreme cases it can result in a dysfunctional process. The <IR> assurance process can be negatively impacted on by all of these issues.

(b) An integrated assurance approach should help facilitate a process whereby all key assurance providers are coordinated, aligned and integrated within the assurance framework. Such an approach can also help improve performance and reduce overheads by helping to avoid confusion and overlap of responsibilities, by helping eliminate duplication of effort and by reducing unnecessary redundancy.