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Richard Howitt,
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Our ref MV/288

2 June 2017

Dear Sir,

Integrated Reporting Framework Implementation Feedback

Thank you for the opportunity to provide feedback on the Framework Implementation. As you know, KPMG has been a strong supporter of the IIRC's work. We recognise the significant potential that the Framework has to drive the scope, content, and relevance of corporate reporting. We have consulted with, and this letter represents the views of, the KPMG network.

In developing our response we have considered the practical experience of KPMG's Better Business Reporting teams around the world in helping companies apply Integrated Reporting principles to their reports and promoting the adoption of Integrated Reporting with investors, companies, and regulators. In our experience, key concepts in the Framework have had a significant beneficial impact on the quality of corporate reporting in general. Whilst in some countries this has resulted in the production of self-declared integrated reports, in others it has resulted in a shift in the focus of corporate reports and corporate reporting frameworks, most notably in a greater emphasis on matters relevant to the underlying health of the business. The role of the Framework in influencing this wider group of report preparers and regulators is often not recognised.

Whilst we acknowledge that reporting practice still has some way to go to meet the ambition of the Framework, we are overall positive about the improvement in quality of reports since the Framework was launched. We believe this gives the IIRC the opportunity to shift emphasis from the take-up of Integrated Reporting to the depth and application of the Framework. In our view there are a number of common barriers to the successful progress of Integrated Reporting. Refinement of the Framework provides an opportunity to address these barriers.

We have structured our comments accordingly, focusing on refinements needed to:

- remove barriers to the integration of <IR> into mainstream corporate reporting;
- address confusion over the relevance of the Framework to investor decision-making; and
- remove barriers to the production of consistent, high quality Integrated Reports.

1. Remove barriers to the integration of <IR> into mainstream corporate reporting

- **Align terminology with established reporting terms / Learning from existing national standards**

Language used in the Framework could be made more business-friendly

In our experience some of the terminology used within the Framework can create a barrier to report preparer's understanding of its requirements. We note a number of specific areas where this is the case in our response below, but as a wider point, we encourage the IIRC to look at the language used in the Framework to ensure that it is more business-friendly. For example, the six capitals terminology is confusing to many who are new to Integrated Reporting, but the concept and relevance of reporting on business critical resources would be readily understood in the corporate world.

In addressing this point, we note that significant lessons can be drawn from national narrative reporting standards that embody key integrated reporting concepts. In particular, we agree with the Financial Reporting Council's view that 'The principles in a UK strategic report are consistent with an integrated report'¹. We suggest that the IIRC examines areas where relevant reporting terminology is already established within national reporting frameworks such as this, as the potential value of Integrated Reporting in helping companies meet existing reporting requirements is frequently not understood.

We encourage the IIRC to extend its technical dialogue with national regulators to support this objective, and also to identify areas where national reporting regulations have addressed challenges relevant to Integrated Reporting. For example, KPMG's research shows the relevance and range of non-financial performance measures reported by German companies is generally much stronger than elsewhere. We attribute this to the GAS20 requirement for companies to consider internal management information flows when determining the KPIs that

¹ Stephen Haddrill: <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/May/Speech-by-Stephen-Haddrill-at-IIRC-event-27-May.aspx>

should be reported externally. The IIRC may consider that a similar approach would be relevant in preparing an Integrated Report.

- **Keep the Reporting Framework distinct from Integrated Thinking strategy theory**

The perception that an Integrated Thinking strategy must be adopted in order to prepare an Integrated Report is a potential barrier to the regulatory adoption of Integrated Reporting as reporting frameworks are ordinarily expected to be strategy-neutral

We recognise the significant attractions of Integrated Thinking as a basis for developing corporate strategy. However, the emphasis on Integrated Thinking within the Framework represents a potential barrier to regulatory adoption as reporting regulators do not generally have the power to require companies to adopt a particular strategic approach to management. We therefore believe clarification is needed to address the perception that an Integrated Thinking strategy is a pre-requisite for adopting Integrated Reporting, notwithstanding that a good integrated report will expose gaps in a company's integrated thinking. It may therefore be desirable to separate the promotion of Integrated Thinking from Integrated Reporting.

2. Ensure the relevance of the Framework to investor decision-making is clear

Integrated Reporting has connected with some groups of investors, notably those individuals focusing on corporate governance, but still needs to achieve mainstream acceptance. We believe the full potential of the Framework will only be realised when its relevance to mainstream investment decision making is understood in the same way that financial reporting is. There are a number of areas of the Framework where the IIRC might consider clarification to ensure its investor relevance is properly understood, and that reporting practice lives up to that ambition.

- **Clarify that the 'capitals' are a means to understanding business strategy rather than a reporting objective in their own right**

Misconceptions over the 'six capitals' concept can lead to confusion over the purpose of an Integrated Report

The capitals concept has the potential to provide investors with highly value-relevant information over the ongoing availability of business critical resources. Unfortunately this is not widely understood. In our experience, investors typically assume that the returns for each capital are a reporting objective in their own right. That leads to the misconception that an integrated report would not directly address the ability of the business to generate financial returns.

We recommend that the Framework is refined to draw a clear distinction between the capitals as inputs to the business, the effect the business has on the quality and availability of those capitals, and the financial outcome of applying the capitals through the business model. In our view this approach would also help to sharpen the focus of strategy, performance, and governance discussions.

We also encounter widespread confusion over the role of the capitals in preparing an Integrated Report. In our experience those companies who approach their report on a 'capitals up' basis tend to be drawn into a siloed approach that struggles to connect with the over-arching strategy and priorities of the business. We believe that the capitals concept can be applied most effectively when used as a tool to ensure that all relevant aspects of business strategy and performance are covered in the report. We suggest adapting the emphasis on the role of the capitals accordingly.

– **Enhance the emphasis on customer and other common investor-relevant indicators of performance**

Some of the most investor-relevant aspects of the Framework are lost in the detail of the capitals

In our experience some of the most immediately relevant benefits of the Framework for investors are hidden in the detail of the capitals. As a result many investors place Integrated Reporting as a branch of corporate social responsibility reporting, whilst report preparers often focus on matters of lower investor relevance whilst omitting areas that are of high relevance.

Most significantly, the quality of a company's customer base and relationships is central to most companies' prospects, but few companies currently include information on whether they are winning or losing customers in their annual reports². Integrated Reporting has the potential to address this gap, but 'customer capital' is not immediately visible in the Framework. Although it falls within relationship capital, report preparers often focus only on the societal relationships.

Similarly, in relation to intellectual capital, investors would welcome additional information on brand and know-how, but many reports chose to focus on social or natural capital or assume that intellectual capital is limited to patents / research activity only. As a result practical measures of brand (for example market share) and know-how (for example retention of skilled staff) performance are being omitted from integrated reports.

² KPMG's research showed that just 17% of annual reports identified whether the company was winning or retaining customers: Room for Improvement, www.kpmg.com/betterbusinessreporting

We acknowledge that these areas are all implicit within the Framework, but believe that this is frequently missed. Aligning the capitals terminology with typical business performance drivers would emphasise the commercial relevance of the Framework, and help report preparers focus on the most business relevant aspects of their capitals.

- **Support the adaptation of IR principles to address other stakeholder needs in add-on ‘more’ reports so that the ‘core’ integrated report can focus on investor-relevant matters**

Report preparers need to focus more on whether or not they are meeting the information requirements of their audience. Confusion over the audience for an Integrated Report is not helping.

As a principles based standard, the success of the Framework is dependent on the extent to which report preparers present information that meets the needs of the report’s primary audience. Although this is stated to be investors, we are concerned that in practice confusion over the audience for an integrated report is resulting in reports that highlight investor-relevant concerns but do not provide the information that investors need to assess the potential impact of those concerns.

We also recognise the significant potential that Integrated Reporting has in meeting the reporting needs of audiences other than investors. To address this, we suggest that the IIRC considers guidance to help companies develop supplementary reports that target the needs of other audiences. Such an approach would be consistent with the refinement of the Framework itself to meet investor needs, whilst still recognising its value to other audiences. Accountancy Europe’s *Core and More*³ concept provides a potential model for doing this that would help companies move towards a single consistent suite of corporate reporting that meets the needs of a variety of different audiences.

3. Remove barriers to the production of consistent, high quality Integrated Reports

Market confusion over the objectives of Integrated Reporting continues to hold back the consistent application of the Framework.

- **Clarify the meaning and application of ‘value creation’**

Report preparers need greater clarity over the ‘value’ they are reporting on, and how value creation for others relates to this.

³ Accountancy Europe, The Future of Corporate Reporting:
<https://www.accountancyeurope.eu/publications/future-corp-rep/>

In our view the Framework's emphasis on value creation has the potential to deliver reports that align well with investors' need to assess the underlying prospects of the business. However, we believe the application of the term needs clarifying if this potential is to be realised. In our experience there is widespread confusion over the meaning of *value creation* in an Integrated Reporting context which can result in wide diversity of practice, and reports that do not align well with investor needs.

The Framework already recognises that an integrated report should focus on matters that affect *the organisation's ability to create value for itself* (§2.7). This aspect of the definition requires greater emphasis as we do not believe it is being consistently applied. We think it would be particularly helpful to draw a direct link between value that can be captured by the organisation and its future cash flows as these represent the foundation of an investment's value. We also suggest that references to value creation in the Framework should explicitly state whether or not they are referring to value captured by the organisation.

– **Clarify the definition of materiality**

An objective test for materiality could address the current diversity of reporting practice

Further guidance is needed to support the application of materiality. In our view, confusion over how to apply materiality in an integrated report is resulting in excessive detail in some areas, and a lack of detail in others. A clearer test is needed that addresses both whether a matter needs to be raised in the report, and whether a piece of information relating to a material matter needs to be disclosed. In keeping with the investor focus of an integrated report, we believe an appropriate objective test would be whether the disclosure of an item of objective information would move an assessment of enterprise value – sometimes described as a '*can I model it?*' test. Such an approach would broadly align with many countries' reporting regimes, and other requirements in relation to the disclosure of market-sensitive information. Its focus on report user decision-making would also be consistent with the goal of producing reports that concisely meet investor needs. We also highlight the potential synergies with the IASB's work on materiality here.

Where reports are prepared other than for investors, we believe that the guidance on reporting boundary and stakeholder consultation could be separated from the investor-focused Framework and developed further as separate guidance to meet the needs of other specific stakeholder groups. We believe this would support the preparation of more focused reports, consistent with the 'core and more' approach highlighted elsewhere in this letter.

– **Emphasise the interaction (connectivity) of report elements in building the report**

The potential of the connectivity concept to deliver a comprehensive joined-up report is not being realised

In our view the connectivity principle provides a powerful basis for building a business focused report without the need for detailed prescriptive disclosures. When applied effectively it should enable companies to build their reports from the business model up, using a consistent narrative that runs across the report content elements to provide objective information on the short, medium, and long term future prospects of the business. However, connectivity of report elements can be a particular problem where report preparation does not have full sponsorship from business leadership which can result in the reporting team delegating content down to departmental silos. This makes the responsibility of those charged with governance key to the commitment to the content of the integrated report. It is therefore important that statements to this effect are included with sufficient basis to show how the board was involved in the development, production, and ownership of the integrated report.

We believe that connectivity within integrated reports does not yet live up to this ambition. For example, we find too many cases where what are said to be strategic priorities are not followed through with relevant KPIs. The current definition of connectivity focuses on providing an ‘holistic picture’ (§3.7). We believe this is too abstract for many to follow, and suggest that it should be refined so that its practical application in developing the report is clearer. In our view, this could most clearly be done by emphasising that matters raised in one content element should be followed through in the other content elements in order to (i) provide sufficient context to assess the potential impact of the matter; and (ii) provide insight into how the company is responding to the matter.

– **Additional guidance required to support specific content elements**

Refinements to the Framework should focus on the practical steps that would have the greatest influence on the most prevalent narrative reporting challenges

Our experience of narrative reporting in general highlights a number of areas of report content where current practice shows significant room for improvement. We believe that the Framework would benefit from some additional detail / refinements in relation to the content elements to address the most common weaknesses in current reporting practice, and have addressed these in our response to question 9. We further suggest that in refining the Framework, the IIRC’s focus should be on the practical changes that are most likely to influence good reporting practice, rather than a more conceptual approach.

Our detailed responses to the questions raised in the consultation are provided as an appendix. Please contact Mark Vaessen at +44 (0)20 7694 8871 if you wish to discuss any of the matters raised in this letter.

Yours sincerely

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Appendix

Q1a: What is your experience with the multiple capitals approach in integrated reports?

The most effective applications of the capitals concept address the underlying health of the business, providing insight into the capability, sustainability, and competitive strengths of the most important aspects of the business. This can provide a basis for discussing the longer term aspects of the business strategy. In practice, we find three broad areas that can present barriers to this:

1. Focusing on the most relevant capitals:

- Multiple capitals are used by most <IR> reporters (and many other reporters), though the range of capitals covered may be limited to the perspectives of those involved in preparing the report, and by confusion over how key business resources fit within the definition of each. This can lead to reports that address only a subset of relevant capitals. This issue most commonly arises where reports are limited to corporate social responsibility matters.
- The naming / definition of six capitals is not familiar and understanding of the definition of capitals takes time. This issue can mean that some of the most business critical aspects of performance are omitted from the company's assessment of capitals.
- Conversely, we find other instances where companies apparently feel they need to report on all capitals rather than select those capitals (or aspects of capitals) that make the difference for that company – i.e. a materiality assessment is not made, resulting in general disclosures that do not align with the unique features of the business.

2. Detail issues:

- Discussion of the capitals is often provided at a high level only. This can result in capitals with markedly different characteristics (for example different groups of customer relationships) being discussed as a single aggregated item. Inappropriate levels of aggregation can mean that whilst reports 'tick the box' on the capitals, the information they provide is of limited value.
- Companies in general tend to take a narrow approach to reporting on intellectual capital, focusing on research activities, but omitting wider aspects of know-how, and also brand aspects of intellectual capital.
- We see a tendency to report what is readily available, rather than what is relevant. In particular, understanding over what a 'capital' represents is variable, and the approach can often be to use available metrics to match with the capitals rather than finding metrics that define the capitals well.

3. Understanding of the capitals concept:

We find a number of conceptual misunderstandings with the application of the capitals concept, which can contribute to a general lack of clarity amongst reporters over why they are reporting on a particular capital:

- Lack of understanding that value creation leads to increase or decrease of capitals that drive business prospects.
- Understanding of the capitals concept is often applied within the organisation on a siloed basis, with each capital delegated to a part of the organisation that may not understand how that capital fits into the overall strategy of the organisation.
- Although companies are making efforts in describing the inter-relation of capitals, they often find this difficult.

Q1b: What, if anything, should be done and by whom to improve this aspect of implementation?

In the introduction to this letter, we suggest the following priorities for developing the Framework:

1. Clarify that the ‘capitals’ are a means to understanding business strategy rather than a reporting objective in their own right

Misconceptions over the ‘six capitals’ concept can lead to confusion over the purpose of an Integrated Report

The capitals concept has the potential to provide investors with highly value-relevant information over the ongoing availability of business critical resources. Unfortunately this is not widely understood. In our experience, investors typically assume that the returns for each capital are a reporting objective in their own right. That leads to the misconception that an integrated report would not directly address the ability of the business to generate financial returns.

We recommend that the Framework is refined to draw a clear distinction between the capitals as inputs to the business, the effect the business has on the quality and availability of those capitals, and the financial outcome of applying the capitals through the business model. In our view this approach would also help to sharpen the focus of strategy, performance, and governance discussions.

We also encounter widespread confusion over the role of the capitals in preparing an Integrated Report. In our experience those companies who approach their report on a ‘capitals up’ basis tend to be drawn into a siloed approach that struggles to connect with the over-arching strategy and priorities of the business. We believe that the capitals concept can be applied most effectively when used as a tool to ensure that all relevant aspects of business strategy and performance are covered in the report. We suggest adapting the emphasis on the role of the capitals accordingly.

2. Enhance the emphasis on customer and other common investor-relevant indicators of performance

Some of the most investor-relevant aspects of the Framework are lost in the detail of the capitals

In our experience some of the most immediately relevant benefits of the Framework for investors are hidden in the detail of the capitals. As a result many investors place Integrated Reporting as a branch of corporate social responsibility reporting, whilst report preparers often focus on matters of lower investor relevance whilst omitting areas that are of high relevance.

Most significantly, the quality of a company's customer base and relationships is central to most companies' prospects, but few companies currently include information on whether they are winning or losing customers in their annual reports. Integrated Reporting has the potential to address this gap, but 'customer capital' is not immediately visible in the Framework. Although it falls within relationship capital, report preparers often focus only on the societal relationships.

Similarly, in relation to intellectual capital, investors would welcome additional information on brand and know-how, but many reports chose to focus on social or natural capital or assume that intellectual capital is limited to patents / research activity only. As a result practical measures of brand (for example market share) and know-how (for example retention of skilled staff) performance are being omitted from integrated reports.

We acknowledge that these areas are all implicit within the Framework, but believe that this is frequently missed. Aligning the capitals terminology with typical business performance drivers would emphasise the commercial relevance of the Framework, and help report preparers focus on the most business relevant aspects of their capitals.

Q2a: What is your experience with connectivity in integrated reports as an indication of integrated thinking and/or enabler of enhanced decisions?

Connectivity is achieved through developing the integrated reporting process around the development and execution of the group strategy and related performance aspects. Companies with a robust and comprehensive strategy that the whole reporting team understands (e.g. with a corporate strategist playing an active role in the report) are therefore most likely to deliver a joined-up report.

In our experience, though, the role of connectivity at a practical level is not well understood or implemented by the majority of the reporters. In particular:

- Many companies are still at the stage of focusing on providing information on the individual content elements / capitals of the Framework rather than connectivity of information. These reports do not explain the thread from business model through risk / opportunity to strategy and monitoring very well and the connections between the capitals are not addressed.
- There can be confusion over what connectivity means in practice, with the practical implications for developing the report being lost

Connectivity of elements is a particular problem where report preparation does not have full sponsorship from business leadership which can result in the reporting team delegating content down to departmental silos. This approach is reinforced by report design processes that are often based on allocating pages to individual corporate departments.

Q2b: What, if anything, should be done and by whom to improve this aspect of implementation?

In the introduction to our letter, we suggest the following priorities for developing the Framework:

- **Emphasise the interaction (connectivity) of report elements in building the report**

The potential of the connectivity concept to deliver a comprehensive joined-up report is not being realised

In our view the connectivity principle provides a powerful basis for building a business focused report without the need for detailed prescriptive disclosures. When applied effectively it should enable companies to build their reports from the business model up, using a consistent narrative that runs across the report content elements to provide objective information on the short, medium, and long term future prospects of the business. However, connectivity of report elements can be

a particular problem where report preparation does not have full sponsorship from business leadership which can result in the reporting team delegating content down to departmental silos. This makes the responsibility of those charged with governance key to the commitment to the content of the integrated report. It is therefore important that statements to this effect are included with sufficient basis to show how the board was involved in the development, production, and ownership of the integrated report.

We believe that connectivity within integrated reports does not yet live up to this ambition. For example, we find too many cases where what are said to be strategic priorities are not followed through with relevant KPIs. The current definition of connectivity focuses on providing an '*holistic picture*' (§3.7). We believe this is too abstract for many to follow, and suggest that it should be refined so that its practical application in developing the report is clearer. In our view, this could most clearly be done by emphasising that matters raised in one content element should be followed through in the other content elements in order to (i) provide sufficient context to assess the potential impact of the matter; and (ii) provide insight into how the company is responding to the matter.

Q3a: What is your experience with the identification, in integrated reports, of key stakeholders' legitimate needs and interests and how those needs and interests are considered and addressed?

The consideration of stakeholder needs links closely to the way in which the capitals concept is applied, therefore the matters raised in our response to Q1a are relevant to this question. Whilst companies may, in practice, be adept at responding to stakeholder needs, they can find it difficult to step back sufficiently to identify this business activity as being a relevant matter to report on. This can lead to weaknesses in the reporting of the capitals. As a result: (i) the mechanisms in place to identify and meet material stakeholders' needs; and (ii) the implications these have (or have had) on the company's strategy are rarely described across all the capitals, even though they may be central to the future prospects of the company.

With respect to companies preparing reports other than for an investor audience, we find that the preparer's goal is sometimes the production of an 'integrated report' rather than the relevance of information provided to the users of the report. Better explanation and guidance by the IIRC (e.g. through a separate paper on the topic) could help to address this aspect.

Q3b: What, if anything, should be done and by whom to improve this aspect of implementation?

In the introduction to our letter, we suggest the following priorities for developing the Framework:

- **Support the adaptation of IR principles to address other stakeholder needs in add-on 'more' reports so that the 'core' integrated report can focus on investor-relevant matters**

Report preparers need to focus more on whether or not they are meeting the information requirements of their audience. Confusion over the audience for an Integrated Report is not helping.

As a principles based standard, the success of the Framework is dependent on the extent to which report preparers present information that meets the needs of the report's primary audience. Although this is stated to be investors, we are concerned that in practice confusion over the audience for an integrated report is resulting in reports that highlight investor-relevant concerns but do not provide the information that investors need to assess the potential impact of those concerns.

We also recognise the significant potential that Integrated Reporting has in meeting the reporting needs of audiences other than investors. To address this, we suggest that the IIRC considers guidance to help companies develop

supplementary reports that target the needs of other audiences. Such an approach would be consistent with the refinement of the Framework itself to meet investor needs, whilst still recognising its value to other audiences. Accountancy Europe's *Core and More* concept provides a potential model for doing this that would help companies move towards a single consistent suite of corporate reporting that meets the needs of a variety of different audiences.

Q4a: What is your experience with the Framework's definition of materiality, in particular: Application of the value creation lens? Use of different time periods to identify material matters?

The relevance of value creation for other stakeholders, and the distinction to value created for the organisation is often not well understood in the context of an Integrated Report, resulting in vague (or missing) connections between value created for the stakeholder and for the organisation. This failure to understand this strategic link can result in a lack of focus, for example, actions or measures may be reported on a company-wide basis, when only one aspect, say, the retention of a core category of staff is critical to business prospects.

The absence of this strategic link can mean that report preparers can find the application of materiality over time to be a particular issue. Different time period perspectives need to be applied in preparing an integrated report, but ultimately need to come back to impact on value as a whole. At this stage, report preparers are not yet used to the discipline of working through the impact of a matter on short, medium, and long term prospects for the business to determine its overall materiality.

The above factors combined with the limited experience most companies have in identifying material matters outside of financial and social responsibility reporting can result in reports that identify as 'integrated reports' focusing primarily on non-financial matters that might be more relevant in a CSR report.

Q4b: What, if anything, should be done and by whom to improve this aspect of implementation?

In the introduction to this letter we suggest the following priorities for developing the Framework:

- **Clarify the meaning and application of 'value creation'**

Report preparers need greater clarity over the 'value' they are reporting on, and how value creation for others relates to this.

In our view the Framework's emphasis on value creation has the potential to deliver reports that align well with investors' need to assess the underlying prospects of the business. However, we believe the application of the term needs clarifying if this potential is to be realised. In our experience there is widespread confusion over the meaning of *value creation* in an Integrated Reporting context which can result in wide diversity of practice, and reports that do not align well with investor needs.

The Framework already recognises that an integrated report should focus on matters that affect *the organisation's ability to create value for itself* (§2.7). This

aspect of the definition requires greater emphasis as we do not believe it is being consistently applied. We think it would be particularly helpful to draw a direct link between value that can be captured by the organisation and its future cash flows as these represent the foundation of an investment's value. We also suggest that references to value creation in the Framework should explicitly state whether or not they are referring to value captured by the organisation.

– **Clarify the definition of materiality**

An objective test for materiality could address the current diversity of reporting practice

Further guidance is needed to support the application of materiality. In our view, confusion over how to apply materiality in an integrated report is resulting in excessive detail in some areas, and a lack of detail in others. A clearer test is needed that addresses both whether a matter needs to be raised in the report, and whether a piece of information relating to a material matter needs to be disclosed. In keeping with the investor focus of an integrated report, we believe an appropriate objective test would be whether the disclosure of an item of objective information would move an assessment of enterprise value – sometimes described as a 'can I model it?' test. Such an approach would broadly align with many countries' reporting regimes, and other requirements in relation to the disclosure of market-sensitive information. Its focus on report user decision-making would also be consistent with the goal of producing reports that concisely meet investor needs. We also highlight the potential synergies with the IASB's work on materiality here.

Where reports are prepared other than for investors, we believe that the guidance on reporting boundary and stakeholder consultation could be separated from the investor-focused Framework and developed further as separate guidance to meet the needs of other specific stakeholder groups. We believe this would support the preparation of more focused reports, consistent with the 'core and more' approach highlighted elsewhere in this letter.

Q5a: What is your experience with the conciseness of integrated reports?

Please see our response to Q4a. In our experience confusion over the application of materiality can result in immaterial disclosures in some areas, and under-disclosure in others.

Q5b: What, if anything, should be done and by whom to improve this aspect of implementation?

No specific comments – we expect that conciseness will follow from better understanding of the purpose and requirements of the Framework.

Q6a: What is your experience with the reporting of business model information, particularly outputs and outcomes?

In our experience the capitals concept is helping companies provide more complete descriptions of their business models, and get closer to addressing their key competitive differentiators. However, whilst the breadth of business model description is improving, many descriptions suggest an underlying lack of clarity of purpose amongst report preparers. In our view the key areas for improvement are therefore:

- Gaps in the business model – Key gaps remain in many business model descriptions – notably intellectual capital (know-how and brand). Further discipline in applying the capitals concept is required here
- Connectivity-gaps - More focus on detail to support the reader's assessment of matters raised elsewhere in the report is needed. For example, if continuity of supply has been identified as a significant risk, descriptions of the diversity, range, and terms of supplier relationships should generally be material to an understanding of the business model. Whilst cross-referencing is increasingly used in reports, the relevance of the information referred to is often not considered.
- User-focus – The business model has a key role to play in helping users interpret the potential impact of issues as they arise throughout the year. However, this is only possible when it provides sufficient granularity of relevant information. So for example, a general discussion of customer relationships may be of little value to an investor if that discussion aggregates two separate groups of customers who provide entirely different margin opportunities.

We also find there can be some confusion between the role of outputs (linking to products, services and impacts) and outcomes (linking to strategic objectives and purpose of the organisation) in the business model, meaning that the reported data does not fully cover the outputs and / or outcomes of the business model. This may be compounded by a tendency to report on the basis of the data/indicators companies have available rather than the data that would be most relevant to the user of the report.

Q6b: What, if anything, should be done and by whom to improve this aspect of implementation?

In our view, improvements to business model disclosure should come from greater involvement of strategy leaders, and corporate planning teams (to provide better understanding of the business's value creation strategy) and investor relations officers (to provide greater focus on meeting report users' information needs) in the preparation of the report, alongside the involvement of finance and company secretary. The effective production of an integrated report requires a genuinely multi-disciplinary team with sponsorship and ultimate ownership by the board.

In the introduction to this letter we suggest the following priorities for developing the Framework:

- **Align terminology with established reporting terms / Learning from existing national standards**

Language used in the Framework could be made more business-friendly

In our experience some of the terminology used within the Framework can create a barrier to report preparer's understanding of its requirements. We note a number of specific areas where this is the case in our response below, but as a wider point, we encourage the IIRC to look at the language used in the Framework to ensure that it is more business-friendly. For example, the *six capitals* terminology is confusing to many who are new to Integrated Reporting, but the concept and relevance of reporting on *business critical resources* would be readily understood in the corporate world.

In addressing this point, we note that significant lessons can be drawn from national narrative reporting standards that embody key integrated reporting concepts. In particular, we agree with the Financial Reporting Council's view that 'The principles in a UK strategic report are consistent with an integrated report'. We suggest that the IIRC examines areas where relevant reporting terminology is already established within national reporting frameworks such as this, as the potential value of Integrated Reporting in helping companies meet existing reporting requirements is frequently not understood.

We encourage the IIRC to extend its technical dialogue with national regulators to support this objective, and also to identify areas where national reporting regulations have addressed challenges relevant to Integrated Reporting. For example, KPMG's research shows the relevance and range of non-financial performance measures reported by German companies is generally much stronger than elsewhere. We attribute this to the GAS20 requirement for companies to consider internal management information flows when determining the KPIs that should be reported externally. The IIRC may consider that a similar approach would be relevant in preparing an Integrated Report.

Q7a: What is your experience with whether reports: (i) identify the involvement of those charged with governance, and (ii) indicate that they are presented in accordance with the Framework? What are the implications of excluding such information?

Practice in identifying the responsibility of those charged with governance in preparing the report varies by country. In many countries it is normal for this to be acknowledged (whether or not the report is an integrated report), and responsibility is also implicit from the board's wider responsibilities under securities laws for disclosure relating to all price-sensitive matters. However, in other jurisdictions, for example, Japan, the identification of the persons responsible for governance is often not discussed in the context of the preparation of the integrated report.

The identification of involvement of those charged with governance is extremely important for the commitment to the content of the integrated report, so it is important that statements to this effect are included with sufficient basis to show how the board was involved in the development, production, and ownership of the integrated report.

Q7b: What, if anything, should be done and by whom to improve these aspects of implementation?

Approaches to enhancing statements of responsibility will depend on national circumstances. However, in general this would require clarification of a board's responsibilities for identifying and disclosing accurate price-relevant information to their investors as part of their routine corporate governance responsibilities. On this basis, the Framework might then provide the basis on which the board can make an assessment over whether or not it has met its disclosure obligations.

As a practical matter, we highlight that non-financial reporting systems are still developing. Whilst financial reporting is subject to an extensive system of controls and due diligence, non-financial information may come from a disparate range of sources that is not subject to the same level of control and scrutiny. This issue has been highlighted by, amongst others, the SEC⁴. The challenges being highlighted by the IIRC's Technology Initiative in sourcing strategically relevant, reliable information for an integrated report are relevant in this respect. Overcoming these will be a key enabler for the mainstream provision of assurance over integrated reports.

⁴ Remarks by the SEC Chief Accountant: <https://www.sec.gov/news/speech/remarks-2017-baruch-college-financial-reporting-conference-advancing-our-capital>

Q8a: What is your experience with the application of these remaining three Guiding Principles in integrated reports [Strategic focus and future orientation; Reliability and completeness; Consistency and comparability]?

Strategic focus and future orientation

Although the Framework provides the building blocks for companies to deliver strategic focus and future orientation, this ambition is not always realised as:

- Strategy discussions can focus on a single time horizon. Either short term (typically operational improvement initiatives addressing revenue enhancement or efficiency savings), or long term (typically enhancement of one or two of the business's capitals). To provide a full strategic focus, reports need to address drivers of short, medium, and long term aspects of performance in a balanced manner. This requires a clear understanding of business strategy from those involved in the preparation of reports
- Future orientation may be confused with an obligation to provide forecast information, which many companies are reluctant to commit to – certainly beyond the short-term. We believe it would be more useful for report preparers to focus on providing information that enabled their investors to assess future prospects for themselves. This may require a further evolution of reporting culture as preparers shift their focus from reporting what they are required to disclose, to what would influence the reader's assessment of a matter. Specifically:
 - a) More needs to be done in analysing and extrapolating key emerging trends observed in risk and opportunity areas
 - b) Performance measures need to be aligned with strategy execution (lead indicators) and strategic outcomes (lag indicators) and ultimately to the value creation strategy of the organisation
 - c) Not many companies report sufficiently on the external environment and the risks and opportunities following from that as input for strategy/resource allocation and outlook
 - d) Outlook needs to be more actively addressed in terms of long term aspirations of the organisation and some more sensitivity or scenario analysis over matters the organisation could be up against in achieving its strategic objectives in the future

Reliability and completeness

In relation to reliability, non-financial reporting systems are still developing. Whilst financial reporting is subject to an extensive system of controls and due diligence, non-financial information may come from a disparate range of sources that is not subject to the same level of control and scrutiny. The challenges being highlighted by the IIRC's

Technology Initiative in sourcing strategically relevant, reliable information for an integrated report are relevant in this respect. Overcoming these will be a key enabler for the mainstream provision of assurance over integrated reports, which we anticipate investors will expect if they are to rely on the information provided in the report.

In relation to completeness, we highlight the difficulties companies are finding in applying the definition of materiality to determine what is required to ‘make the report complete’.

Consistency and comparability

We recognise that there can be a tension between providing information that is strategically relevant to the circumstances of the company, and information that supports comparison with peers. The former quality is more important for in-depth analysis of a company’s performance against its strategy, whilst the latter would support ratio comparison by data aggregators. Companies will ultimately need to assess the use to which the information they provide will be put in order to determine which quality to prioritise. However, at this stage, we believe the challenges of reliability and availability of connected information need to be resolved first.

Q8b: What, if anything, should be done and by whom to improve these aspects of implementation?

The above challenges relate largely to reporting culture – they require that report preparers will need to:

- think across the short, medium, and longer term to address the overall value impact to the business;
- have a stronger understanding of the underlying business strategy; and
- develop a stronger understanding of their readers’ decision making requirements in order to determine the information they need from the report.

Q9a: What is your experience with how these remaining Content Elements are reported in integrated reports?

We make specific comment on each of the content elements below. As a general point, though, companies still face challenges in applying the connectivity of information to disclose matters required by the Framework (addressed in Q2).

Organisational overview and external environment

Typically organisational overview forms part of the business model discussion. In our view, this is a helpful approach.

External environment discussions can vary in scope with some focusing on short term factors (e.g. the operation of macro-economic factors), whilst others emphasise medium term factors such as competitive threats from existing competitors. Longer term discussions are rarer, but in our experience, the most insightful address questions over the ongoing relevance of the business model, security of key business resources, and threats from new entrants / technologies. It is relatively rare to find a discussion of external factors addressing all time horizons. Although the external environment discussion should naturally connect with other elements of the report, this is often not the case, and is therefore a key area where connectivity could be better applied.

Governance

Where connectivity is applied most effectively in governance discussions, it results in a more dynamic discussion that shows how the board is contributing to the business by addressing its key challenges and opportunities. However, discussions with this level of insight are relatively rare. Many governance disclosures give the impression that they have been developed in isolation from the rest of the report as they do not talk to the issues raised elsewhere in the report. This can result in reports that provide relatively generic descriptions of governance process, rather than genuine insight into the unique governance priorities of the organisation.

Risks and opportunities

In practice, risk reporting content tends to be driven by national practice. Whilst some countries' disclosures have a strong focus on factors affecting the future prospects of the organisation, others emphasise particular areas of risk so that some risks become almost standard practice disclosures. Risk and opportunity disclosures need to be distilled to the most pressing material matters that present themselves to the organisation. Additionally, whilst it is common to address the company's approach to managing the risk of an issue arising, it is much less common to provide insight into how the organisation would respond to mitigate its impacts if it did so.

We also note that national regulation of risk reporting can mean the discussion of opportunities is separated from the discussion of risk.

Strategy and resource allocation

Please see our response to Q8a.

Performance

Operational performance reporting is the area where Integrated Reporting potentially has the most to offer investor decision making by providing focused information that is relevant to understanding the business's strategy and prospects.

At this stage in the development of Integrated Reporting, we find that the choice of performance measures being reported can depend more on what is readily available than relevance. This issue is not unique to Integrated Reporting, but it represents a significant barrier to investors realising the benefits of an integrated report.

We attribute this to two underlying factors:

- **Report preparers need more direction to focus on the relevance of the performance information that they are reporting. In our view, this should address**
 - The relevance to the business of what is reported, covering (i) progress indicators addressing progress in implementing strategy / managing risks; (ii) outcome indicators addressing the commercial outcomes that drive future financial prospects.
 - The relevance to investors / report users of what is reported. Reports are often drafted without a specific user in mind. This lack of consideration of end-user needs can mean that the performance information reported has limited value to support decision making
- **Secondly, there is a need to develop better non-financial reporting systems. We welcome the work of the IIRC's Technology Initiative in this respect.**

Outlook

In our view, the Framework's most significant contribution to forward looking reporting stems from the factual information and related interpretation it asks companies to provide in relation to their strategy, business environment, and leading indicators of performance. We have highlighted the challenges in producing a future oriented report in our response to Q8a.

In relation to the provision of forecast or target information, we have the following comments:

- The reporting of an outlook for financial performance and related commercial drivers tends to follow either national requirements or be driven by companies' existing investor relations priorities – we expect that this will continue to be the case.
- Forecast or target information (whether financial or non-financial) is most helpful when it provides the focus for a discussion that gives management's perspective on the key factors likely to affect future performance. Forecasts or targets presented without a supporting rationale are of limited value in the context of an integrated report.

Q9b: What, if anything, should be done and by whom to improve these aspects of implementation?

Please see our responses to Q9a (specific content elements); Q4b (clarification of value creation and materiality); Q2b (application of connectivity); Q6b (clarifying terminology).

Q10a: Aside from any quality issues already raised in Q1-Q9, what is your experience with the quality of integrated reports?

In our experience, key concepts in the Framework have had a significant beneficial impact on the quality of corporate reporting in general. Whilst in some countries this has resulted in the production of self-declared integrated reports, in others it has resulted in a shift in the focus of corporate reports and corporate reporting frameworks, most notably in a greater emphasis on matters relevant to the underlying health of the business. The role of the Framework in influencing this wider group of report preparers and regulators is often not recognised.

Whilst we acknowledge that reporting practice still has some way to go to meet the ambition of the Framework, we are overall positive about the improvement in quality of reports since the Framework was launched. We believe this gives the IIRC the opportunity to shift emphasis from the take-up of Integrated Reporting to the depth and application of the Framework.

Q10b: What, if anything, should be done and by whom to improve this aspect of implementation

No further comment.

Q11a: What is your experience with enablers, incentives or barriers to Framework implementation not covered by other questions, including the extent to which they apply particularly to: Specific jurisdictions; Large or small organisations; Private, public or non-profit sectors; Different stages of Framework implementation?

The IIRC has rightly, in our opinion, adopted a market-led approach to Integrated Reporting, therefore the main challenges to the further progression of Integrated Reporting relate to seeing and understanding the value of IR for both business and investors. Our letter highlights the following general factors in this regard:

- Barriers to the integration of <IR> into mainstream corporate reporting;
- Confusion over the relevance of the Framework to investor decision-making; and
- Barriers to the production of consistent, high quality Integrated Reports.

In relation to more specific factors, not raised elsewhere in our letter, we highlight the following:

- Lack of safe harbour protection in some jurisdictions
- Perceived differences in alignment between integrated reporting and national regulatory requirements
- Barriers to public sector application – Whilst the South African regulatory and business environment has been particularly supportive and conducive to the adoption of integrated reporting, public sector frameworks could be better aligned with the <IR> Framework and King IV

We also note that changes to national corporate governance codes (for example, in the Netherlands and the UK) which place greater emphasis on longer-term aspects of shareholder value, can be seen as enablers for integrated reporting in the future. Additionally, the best practices deployed by large listed companies can be a stimulus for other companies – including smaller – to explore and implement integrated reporting.

Q11b: What, if anything, should be done and by whom to improve these aspects of implementation?

No further comment.