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<IR> in Focus
The IIRC releases the International Integrated Reporting <IR> Framework

Contents

The Bottom Line

- The International Integrated Reporting Council ('the IIRC') released the International Integrated Reporting <IR> Framework ('the <IR> Framework') on 9 December 2013.
- An integrated report is "a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term."
- The primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time.
- The <IR> Framework is a principles-based framework for the preparation of an integrated report. Part I provides guidance on how to use the <IR> Framework, which includes a definition of an integrated report, distinguishes reporting in accordance with the <IR> Framework from other forms of reporting and explains the fundamental concepts of Integrated Reporting. Part II contains the seven Guiding Principles and eight Content Elements for the preparation and presentation of an integrated report.
- The <IR> Framework is clearly structured and the potential sources of confusion highlighted by respondents to the April 2013 consultation draft appear to have been resolved.
- There is currently no regulatory requirement for <IR> except in South Africa. It is a market-led initiative that aims to encourage companies to communicate their value creation story, rather than create another compliance burden.

Introduction and objective of Integrated Reporting <IR>

On 9 December 2013, the International Integrated Reporting Council ('the IIRC') released the *International Integrated Reporting <IR> Framework* ('the <IR> Framework'). The IIRC is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. Its view is based on a belief that corporate reporting must evolve to communicate the full range of factors affecting an organisation's ability to create value over the short, medium and long term. These factors are not purely traditional financial or manufactured capital but include, equally, the human, intellectual, social and relationship, and natural capitals that an organisation relies on to do business in the 21st Century. Integrated Reporting, or <IR>, is not combined reporting.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

Therefore, an integrated report is not a report that combines the financial statements or annual report and any separate corporate responsibility or sustainability report into one report (see 'Form of report and relationship with other information' below). It is a concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term." The aims of <IR>, as set out in the 'About Integrated Reporting' introductory section to the <IR> Framework, are to:

- "Improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital
- Promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organisation to create value over time
- Enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social and relationship, and natural) and promote understanding of their interdependencies
- Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term."

Observation

A stated aim of <IR> is to support integrated thinking and decision-making. Integrated thinking is "the active consideration by an organisation of the relationships between its various operating and functional units and the capitals that the organisation uses or affects". Integrated Reporting is also an output of integrated thinking, i.e. one is a function of the other.

Many of the <IR> Pilot Programme businesses are starting with integrated thinking by applying the concepts of <IR> internally to adapt internal information systems and decision-making, before producing external integrated reports. The 2013 Pilot Programme yearbook available at: www.theiirc.org provides further details and case studies of how Pilot Programme businesses are evolving to <IR>.

The <IR> Framework

The <IR> Framework is organised into two parts or four chapters:

- Part I provides background on (i) using the Framework and its objective, and the purpose and users of an integrated report, amongst other items and (ii) the fundamental concepts of <IR>.
- Part II sets out (iii) Guiding Principles and (iv) Content Elements for the preparation and presentation of an integrated report.

Both Parts I and II include ***bold italic type requirements*** with which any communication claiming to be an integrated report in accordance with the <IR> Framework should comply. They are listed in an appendix to the <IR> Framework and are also included in a table as an appendix to this newsletter.

Purpose and users of an integrated report

The primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time.

Observation

Although the primary focus here is on providers of financial capital, an integrated report benefits all stakeholders interested in an organisation's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators, and policy-makers. This is because how the organisation interacts with the external environment and the capitals (financial, manufactured, intellectual, human, social and relationship, and natural) affects its ability to create value over the short, medium and long term.

Form of report and relationship with other information

An integrated report is different from financial statements and sustainability reports. It is "a designated, identifiable communication." It may form part of another report prepared by an organisation for compliance purposes, provided any other information required for compliance purposes does not obscure that required by the <IR> Framework.

> Observation
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> The IIRC's vision is bold: ideally, integrated thinking and <IR> will become the norm, with the concepts of <IR> thoroughly embedded in every form of communication by an organisation to stakeholders both external and internal (externally across the corporate reporting suite from the statutory report to a quarterly investor presentation and internally, within management reports). The preface to and paragraph 3.7 of the Framework state: "The more that integrated thinking is embedded into an organisation's activities, the more naturally will the connectivity of information flow into management reporting, analysis and decision-making."

Statement of compliance

Any communication claiming to be an integrated report and referencing the <IR> Framework must comply with all the requirements identified in bold italic type, except in three instances, where:

(i) reliable information is unavailable, or

(ii) specific legal prohibitions result in an inability to disclose material information, or

(iii) disclosure of material information would cause significant competitive harm.

In the first two instances, the organisation must indicate the nature of the information omitted, explain the reason why it has been omitted, and, in the case of the unavailability of data, identify the steps being taken to obtain the information and expected time frame for doing so.

In respect of non-disclosure for competitive harm reasons, the <IR> Framework states that an organisation considers "how to describe the essence of the matter without identifying specific information that might cause a significant loss of competitive advantage" and that "Accordingly, the organisation considers what advantage a competitor could actually gain from information in an integrated report, and balances this against the need for the integrated report to achieve its primary purpose", as noted in the <IR> Framework.

Role of those charged with corporate governance

An integrated report in compliance with the <IR> Framework includes a statement from those charged with governance acknowledging their responsibility for ensuring the integrity of the integrated report, that they have applied their collective mind to the preparation and presentation of the integrated report and their opinion or conclusion about whether it is presented in accordance with the <IR> Framework.

If such a statement is not included, the integrated report is required to explain the role that those charged with governance played in its preparation and presentation, the steps being taken to include such a statement in future reports and time frame for doing so, which should be no later than the organisation's third report referencing the <IR> Framework.

> Observation
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> This question of whether those charged with governance should provide a statement acknowledging their responsibility was the single most contentious issue arising from the consultation with only just over 50% of respondents in support. Investor representatives in general felt such a statement is necessary to add credibility to the integrated report and prevent it being seen as a marketing document. The principal argument against came from respondents in countries like Japan where there is currently no requirement for such a statement in relation to Financial Statements and there is no evidence that this has caused investors to look less favourably on Japanese stocks. By holding Integrating Reporting to a higher standard, the IIRC risks discouraging take up in such markets. Time will tell whether this proves to be the case.

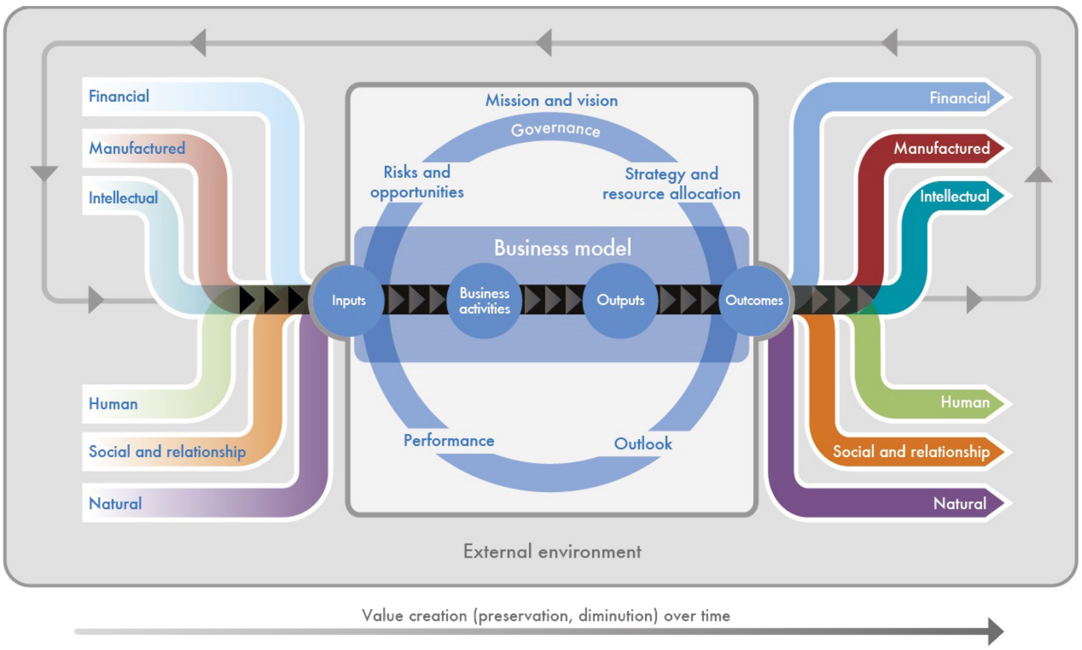
The fundamental concepts of <IR>

There are three fundamental concepts underpinning <IR>:

1. Value creation for the organisation and for others.
2. The capitals.
3. The value creation process.

The value creation diagram in the <IR> Framework links the fundamental concepts of <IR> to the Content Elements of an integrated report.

The Value Creation Diagram from the <IR> Framework reproduced here with the permission of the IIRC



1. Value creation for the organisation and for others. The <IR> Framework notes that "value created by an organisation over time manifests itself in increases, decreases or transformations of the capitals caused by the organisation's business activities and outputs. That value has two interrelated aspects – value created for:

- The organisation itself, which enables financial returns to the providers of financial capital.
- Others (i.e., stakeholders and society at large)."

The <IR> Framework notes here that providers of financial capital are "interested in the value an organisation creates for others when it affects the ability of the organisation to create value for itself, or relates to a stated objective of the organisation (e.g., an explicit social purpose) that affects their assessments."

Observation

The premise here is that whether an organisation creates value for others materially affects the organisation's ability to create value for itself. And whether an organisation creates value for itself materially affects its ability to create value for others. This is why an organisation's business model and value creation process is of interest not only to providers of financial capital but also benefits all stakeholders interested in an organisation's ability to create value over time.

The value creation process diagram in the <IR> Framework provides an effective diagrammatical representation of this dynamic relationship: an organisation's activities, its interactions and relationships, its outputs and the outcomes for the various capitals it uses and affects influence its ability to continue to draw on these capitals in a continuous cycle.

2. The capitals. The capitals are "the resources and the relationships used and affected by the organisation", and are categorized in the <IR> Framework "as financial, manufactured, intellectual, human, social and relationship, and natural". This categorisation is a guideline only to ensure an organisation does not overlook a capital it uses or affects. The <IR> Framework does not require organisations preparing an integrated report to adopt this categorization.

The <IR> Framework defines the capitals as "stocks of value that are increased, decreased or transformed through the activities and outputs of the organisation" and gives several examples (such as improving human capital through employee training, the related training costs reducing financial capital).

The <IR> Framework is explicit that it does not require an organisation to quantify or monetize its use of or effects on all the capitals; quantitative indicators are included in an integrated report only whenever it is practicable and relevant to do so. The <IR> Framework states that "the ability of the organisation to create value can best be reported on through a combination of quantitative and qualitative information".

An integrated report should consider disclosure of the important interdependencies or trade-offs between capitals or between components of a capital that influence value creation over time (for example, creating employment through an activity that negatively affects the environment).

Observation
The <IR> Framework does not expect an organisation's integrated report to cover all the capitals as not all the capitals will be equally relevant to all organisations. It is possible that an organisation's interaction with some of the capitals is not sufficiently important for inclusion in its integrated report.

3. The value creation process. This process is captured in a diagram in the <IR> Framework (reproduced on page 4). This diagram links the various components of the value creation process with all the Content Elements of an integrated report (see below). In particular, the explanatory text links to the 'Business model' Content Element as follows: "At the core of the organisation is its business model, which draws on various capitals as inputs and, through its business activities, converts them to outputs (products, services, by-products and waste). The organisation's activities and its outputs lead to outcomes in terms of effects on the capitals." The <IR> Framework explains further that "Outcomes are the internal and external consequences (positive and negative) for the capitals as a result of an organisation's business activities and outputs."

Observation
The value creation process diagram in the <IR> Framework (see page 4) demonstrates the linkage of an organisation's business model, which should not be static but dynamic, to its ability to create value. The outcomes for the relevant capitals are as important as the organisation's outputs (products and services) to the ability of the organisation to continue to be able to create value for itself.

The building blocks of an integrated report – the seven Guiding Principles and eight Content Elements

Ultimately the content of an integrated report will depend on the individual circumstances of the organisation and the exercise of judgment by senior management and those charged with governance, applying the <IR> Framework's Guiding Principles and Content Elements, to determine what is reported.

An organisation is not required to structure its report using the order of the Content Elements in the <IR> Framework but is required to present the content in a way that makes clear the interconnections between them.

Guiding Principles	Content Elements
Seven Guiding Principles underpin the preparation and presentation of an integrated report, informing its content and how information is presented:	The seven Guiding Principles are applied in preparing an integrated report, which is required to include eight key elements:
A. Strategic focus and future orientation B. Connectivity of information C. Stakeholder relationships D. Materiality E. Conciseness F. Reliability and completeness G. Consistency and comparability	A. Organisational overview and external environment B. Governance C. Business model D. Risks and opportunities E. Strategy and resource allocation F. Performance G. Outlook H. Basis of preparation and presentation

Observation

Judgement will be required when there is an apparent tension between the Guiding Principles (for example, between conciseness and completeness). The <IR> Framework does not provide additional guidance on how to make this judgement but notes that "the Guiding Principles are applied individually and collectively for the purpose of preparing and presenting an integrated report."

Key aspects of the Guiding Principles and Content Elements that one may be guided by, when making that judgement include:

- A focus not solely on the short term but a medium to long-term view.
- Reflecting the importance of relationships with key stakeholders, providing insight into the nature and quality of the organisation's relationships with them, including how and to what extent the organisation understands, takes into account and responds to their legitimate needs and interests.
- Application of the materiality concept to determine the content of an integrated report, based on an assessment of those matters that substantively affect the organisation's ability to create value over the short, medium and long term. The organisation's reporting boundary for an integrated report will be central to the application of the materiality concept in the context of the broader capitals <IR> considers.
- Connectivity of information presented within the integrated report (for example, linkage between strategy, risks and opportunities, and performance, including financial and non-financial KPIs) and to further information available in the organisation's other communications.
- A future orientation, including a clear articulation about the availability, quality and affordability of the capitals the organisation uses or affects.
- The basis of preparation and presentation for the report, including any other significant frameworks used to quantify or evaluate material matters for inclusion in the report, in addition to disclosure of:

  – a summary of the organisation's materiality determination process;
  – a description of the reporting boundary and how it has been determined.

Reporting boundary for an integrated report

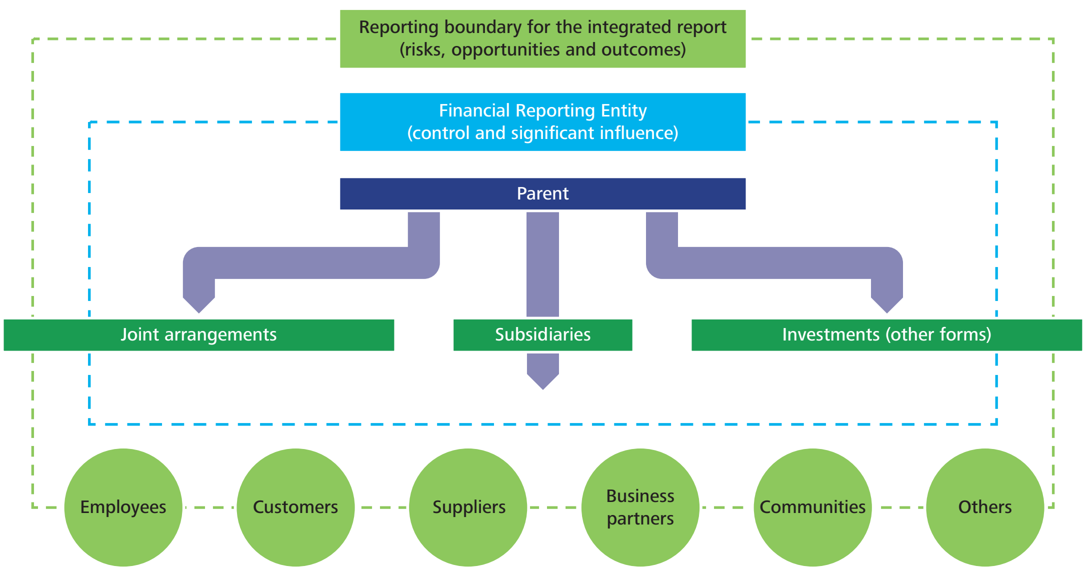
The <IR> Framework includes the concept of the 'reporting boundary' as a component of the materiality determination process. Considering the organisation's reporting boundary has two aspects:

- The financial reporting boundary which identifies the subsidiaries, joint ventures and associates' transactions and related events included in the organisation's financial report, determined according to applicable financial reporting standards.
- A wider boundary beyond the financial reporting boundary to identify those risks, opportunities and outcomes attributable to or associated with entities or stakeholders beyond the financial reporting entity that have a significant effect on the ability of the financial reporting entity to create value. These other entities/stakeholders could be "related parties" for the purpose of financial reporting, but, according to the <IR> Framework "will ordinarily extend further." Examples given in the <IR> Framework depiction of the reporting boundary for an integrated report include employees, customers, suppliers, business partners, communities and others.

Observation

The entities/stakeholders beyond the financial reporting boundary reflected in the <IR> Framework depiction of the reporting boundary may be those considered by organisations for the purposes of standalone corporate responsibility or sustainability reports.

The reporting boundary diagram in the <IR> Framework, reproduced here with the permission of the IIRC



Supporting guidance and documentation

The <IR> Framework includes a section *4I General reporting guidance* that includes further guidance on matters relevant to various Content Elements: (i) disclosure of material matters (including the characteristics of suitable quantitative indicators), (ii) disclosures about the capitals, (iii) time frames for short, medium and long-term and (iv) aggregation and disaggregation.

The <IR> Framework is accompanied by two documents: a Basis for Conclusions and a 'Summary of Significant Issues' document identifying at a more detailed level how various issues raised by respondents to the April 2013 Consultation Draft were treated, as well as mapping significant changes in structure and movements of text from the Consultation Draft to the <IR> Framework. Both of these documents and the Framework itself are available on the IIRC's website at www.theiirc.org.

The Pilot Programmes for <IR> for businesses and investors

The IIRC calls the Pilot Programme for <IR> an "innovation hub". There are two Pilot Programme networks: one for businesses and one for investors.

There are 100 businesses participating in the Pilot Programme for <IR> for businesses (now in its third year). They are a large and diverse group from various regions across the world and from various industries. They include Deutsche Bank, HSBC, Hyundai Engineering and Construction, Microsoft, National Australia Bank, PepsiCo, Tata Steel and Unilever.

Investor Pilot Programme participants include AMP, Blackrock, Government Employees Pension Fund of South Africa, Goldman Sachs, Groupama, ING, Natixis, Norges Bank, Nissay (of Nippon) and State Street Global Advisors.

Examples of emerging <IR> practice

The IIRC has an emerging <IR> database of examples from various annual and integrated reports that illustrate specific Guiding Principles and Content Elements. This database is accessible at www.theiirc.org.

Emerging <IR> practice reporters referred to by the IIRC include: Marks & Spencer Group plc (on governance), Lawson, Inc and Sasol (on business model), Schipol (risks and opportunities), New Zealand Group and Gold Fields (strategy), Stockland and Nedbank Group (financial performance), and ARM holdings plc and Novo-Nordisk (outlook).

Appendix

Table summarising the bold italic type requirements of the <IR> Framework relevant to the preparation of an integrated report	
Application of the Framework	
1E Form of report and relationship with other information	*1.12. An integrated report should be a designated, identifiable communication.*
1F Application of the Framework	*1.17. Any communication claiming to be an integrated report and referencing the Framework should apply all the requirements identified in bold italic type unless:* • *The unavailability of reliable information or specific legal prohibitions results in an inability to disclose material information* • *Disclosure of material information would cause significant competitive harm. (See paragraph 3.51.)* *1.18. In the case of the unavailability of reliable information or specific legal prohibitions, an integrated report should:* • *Indicate the nature of the information that has been omitted* • *Explain the reason why it has been omitted* • *In the case of the unavailability of data, identify the steps being taken to obtain the information and the expected time frame for doing so.* *1.20. An integrated report should include a statement from those charged with governance that includes:* • *An acknowledgement of their responsibility to ensure the integrity of the integrated report* • *That they have applied their collective mind to the preparation and presentation of the integrated report* • *Their opinion or conclusion about whether the integrated report is presented in accordance with this Framework* *or, if it does not, it should explain:* • *What role those charged with governance played in its preparation and presentation* • *What steps are being taken to include such a statement in future reports* • *The time frame for doing so, which should be no later than the organisation's third integrated report that references this Framework.*
Guiding Principles	
3A Strategic focus and future orientation	*3.3 An integrated report should provide insight into the organisation's strategy, and how that relates to its ability to create value in the short, medium and long term and to its use of and effects on the capitals.*
3B Connectivity of information	*3.6 An integrated report should show a holistic picture of the combination, inter-relatedness and dependencies between the factors that affect the organisation's ability to create value over time.*
3C Stakeholder relationships	*3.10 An integrated report should provide insight into the nature and quality of the organisation's relationships with its key stakeholders, including how and to what extent the organisation understands, takes into account and responds to their legitimate needs and interests.*
3D Materiality	*3.17 An integrated report should disclose information about matters that substantially affect the organisation's ability to create value over the short, medium and long term.*
3E Conciseness	*3.36 An integrated report should be concise.*
3F Reliability and completeness	*3.39 An integrated report should include all material matters, both positive and negative, in a balanced way and without material error.*
3G Consistency and comparability	*3.54 The information in an integrated report should be presented (a) on a basis that is consistent over time and, (b) in a way that enables comparison with other organisations to the extent it is material to the organisation's own ability to create value in the short, medium and long term.*
Content Elements	
4A Organisational overview and external environment	*4.4 An integrated report should answer the question: What does the organisation do and what are the circumstances under which it operates?*
4B Governance	*4.8 An integrated report should answer the question: How does the organisation's governance structure support its ability to create value in the short, medium and long term?*
4C Business model	*4.10 An integrated report should answer the question: What is the organisation's business model?*
4D Risks and opportunities	*4.23 An integrated report should answer the question: What are the specific risks and opportunities that affect the organisation's ability to create value over the short, medium and long term, and how is the organisation dealing with them?*
4E Strategy and resource allocation	*4.27 An integrated report should answer the question: Where does the organisation want to go and how does it intend to get there?*
4F Performance	*4.30 An integrated report should answer the question: To what extent has the organisation achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?*
4G Outlook	*4.34 An integrated report should answer the question: What challenges and uncertainties is the organisation likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?*
4H Basis of preparation and presentation	*4.40 An integrated report should answer the question: How does the organisation determine what matters to include in the integrated report and how are such matters quantified or evaluated?*

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