# Commettee serves

Integrated Reporting –
a guide for Audit Committees
in Australia and New Zealand





### Institute of Chartered Accountants Australia

The Institute represents accounting and business professionals in Australia and around the globe. Members strive to uphold financial integrity through a commitment to ethics and acting in the public interest.

We focus on educating candidates through the Chartered Accountants Program and engage in advocacy and thought leadership underpinned by our members' knowledge and experience. We influence a range of policy areas impacting the Australian economy and domestic and international capital markets.

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# **Foreword**

Organisations have the difficult task of balancing demands for more information while also making reports meaningful for a broader range of stakeholders. While there has been progress in reporting of non-financial information, including environmental, sustainability and gender equality indicators, a gap has emerged in holistic reporting.

The integrated reporting framework has been designed to help organisations fill this gap. Developed by the International Integrated Reporting Council through a global consultation process, the framework provides guidance on better demonstrating links between an organisation's strategy, governance and business model.

Organisations taking this approach have reported considerable benefits and stakeholders are better able to evaluate an entity's performance over a longer time by having access to the bigger picture. Integrated reporting will become increasingly necessary as a broader variety of stakeholders demand greater transparency and accessibility.

This is the seventh guide in the Institute of Chartered Accountants Australia's audit committee series. I trust that this guide will provide useful information for members of audit committees in Australia and New Zealand as their organisations begin their integrated reporting journey.

Mel Ashton FCA

M. Ashton

President

Institute of Chartered Accountants Australia

'The role of the audit committee has expanded beyond the financial information and now extends to examining non-financial information as well'

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# Part A – About Integrated Reporting <IR>

This guide is intended to inform members of audit committees and directors about integrated reporting (<IR>) and how it can benefit organisations you work with as well as some of the challenges around implementation.

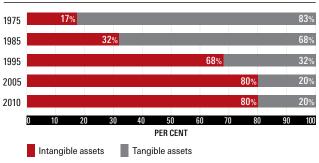
**INTEGRATED REPORT** A concise communication about how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term.1

### 1. BACKGROUND TO <IR>

The increasing complexity of business, and regulatory and societal demands for more information, have led to 'disclosure overload' and corporate reports that are largely compliance focussed, costly to produce and more lengthy but less useful.

At the same time, financial statements alone no longer provide all the information investors need to assess corporate performance and value. Recent studies show that around 80% of an organisation's value is now intangible, compared to around 20% over 30 years ago.

### COMPONENTS OF S&P 500 MARKET VALUE



Source: Ocean Tomo<sup>2</sup>

While there is growing focus on reporting both financial and non-financial information, including such areas as environment and diversity, there remains a gap in holistic reporting by entities to key stakeholders.

Globally we have seen requirements introduced for broader narrative commentary, for example through the Operating and Financial Review (OFR) in Australia and the Strategic Report in the United Kingdom.

Organisations are increasingly considering their impact on society and the environment and engaging in broader stakeholder consultation. The volume of reporting has been increasing, with companies preparing a suite of reports including sustainability

reports and investor presentations, however there often remains a lack of connectivity between the various communications as well as between the financial and non-financial information reported.

Mutual Australian bank, bankmecu believes the true value of reporting is yet to be realised:

"...reporting requires a much clearer correlation between sustainable development and the creation of long-term shareholder value.'3

### INTERNATIONAL INTEGRATED REPORTING COUNCIL

The International Integrated Reporting Council (IIRC) was established in 2010 and is a global coalition of regulators, investors, companies, standard setters, the accounting profession and non-governmental organisations who have come together to advance holistic corporate reporting.

<IR> represents the evolution and consolidation of many years of work by various stakeholders around the need to make corporate reporting more meaningful. The IIRC states that <IR> can promote:

"... a more cohesive and efficient approach to corporate reporting and aims to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.' 4

The IIRC released a consultation draft on an Integrated Reporting framework in April 2013 and received 359 submissions in response to the draft.

'Many drivers of company value, such as human and intellectual capital, are not accounted for in conventional corporate reports; short-changing corporate investments and initiatives whose payoffs are longer term... An integrated report offers a fuller, more coherent picture of those things that matter to a company's current position and future prospects,' Regnan Engagement Manager Alison George [media release 16 April 2013]

The IIRC launched the International <IR> Framework in December 2013 after extensive public consultation. The Framework provides the fundamental concepts, guiding principles and content elements that underpin and inform the content of an integrated report. The primary purpose of the Framework is to assist preparers of corporate reports explain to providers of financial capital how an organisation creates value over time.

The International <IR> Framework, The IIRC, December 2013, p33

www.oceantomo.com/productsandservices/investments/intangible-market-value

www.bankmecu.com.au/reports/annual-report-2011/chapter-2/spotlights.html#Spotlightintegratedreporting, sourced 8 January 2014

www.theiirc.org/about/aboutwhy-do-we-need-the-iirc, sourced 8 January 2014

### 2. WHAT ARE THE BENEFITS?

### FOR COMPANIES AND OTHER ORGANISATIONS:

- Better articulation of strategy for the business and how its business model is responding to changing needs and expectations in the marketplace
- More control over the 'value story' and less need for stakeholders to rely on third party interpretations
- Effective targeting of communications
- Improved dialogue between the business and stakeholders, including providers of financial capital (externally) and employees (internally)
- Greater interconnectedness between departments, divisions and business units, breaking down silos in an organisation
- Potential for a lower cost of capital<sup>5</sup>
- · Decrease in the number of reports and reduced reporting clutter.

<IR> is also beneficial for public sector and not for profit organisations. All types of organisations need to create value for their stakeholders and are also in competition for sources of funding, whether from government or donors. Therefore the more effectively an organisation can demonstrate its business model and how it is delivering on the stated strategy, the better it can differentiate itself from competitors through improved reporting on outcomes and impacts. <IR> accommodates all intangible factors and the following example focuses on social and environmental factors.

### **BANKMECU EXAMPLE**

Satisfying the expectations of people and organisations engaged within the community sector demands a responsible approach to banking that reflects customer attitudes and values, as we invest customers' funds for economic, social and environmental return.6

Bankmecu have observed that greater transparency and accountability leads to a number of benefits, including:7

- Enhanced corporate reputation
- Securing and maintaining a social licence to operate
- A reduced risk profile
- Attraction and retention of high calibre employees
- Better alignment of stakeholder needs with management focus
- Improved access to the growing socially progressive consumer and community sector market.

The process of <IR>, including the development of integrated thinking, will also benefit management and those charged with governance, as they will have better information on which to base decisions about how the organisation can create value in the short, medium and long term.8

**INTEGRATED THINKING** 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 thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term. Integrated thinking can be contrasted with what is sometimes known as 'silo thinking', in that it takes into account the connectivity and interdependencies between the range of factors that affect an organisation's ability to create value over time.9

### FOR INVESTORS:

- <IR> makes clearer the connections between an organisation's strategy, governance, performance and prospects - investors are therefore able to assess more effectively the combined impact of diverse factors and leading indicators of performance
- Clear identification of risks and articulation of how these risks are managed provides investors with the ability to compare management's view with their own. This could potentially increase confidence that the business understands its own risks and that risk management is therefore more likely to be effective
- More effective capital allocation decisions leading to better long-term investment returns.10

Given that providers of financial capital are central to <IR>, it is of critical importance that <IR> content is also included in disclosures designed for investors for investment decision making.

### FOR OTHER STAKEHOLDERS

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.

<sup>5.</sup> www.theiirc.org/about/aboutwhy-do-we-need-the-iirc, sourced 8 January 2014

<sup>6.</sup> Corporate Report 2013, bankmecu p4

<sup>7.</sup> www.bankmecu.com.au/why-bank-with-us/corporate/reporting.html, sourced 8 January 2014

The International <IR> Framework, The IIRC, December 2013, p4

<sup>9.</sup> www.theiirc.org/resources-2/fags, sourced 8 January 2014

<sup>10.</sup> www.theiirc.org/about/aboutwhy-do-we-need-the-iirc, sourced 8 January 2014

STAKEHOLDERS Those groups or individuals that can reasonably be expected to be significantly affected by an organisation's business activities, outputs or outcomes, or whose actions can reasonably be expected to significantly affect the ability of the organisation to create value over time. Stakeholders may include providers of financial capital, employees, customers, suppliers, business partners, local communities, NGOs, environmental groups, legislators, regulators and policy-makers.11

Whilst the primary candidates for the International <IR> Framework are listed entities, there is an acknowledgement within the framework of the value for all stakeholders and hence a broader range of organisations. The Institute has long advocated the application of <IR> to a broader audience, including through its publication Enhancing not for profit annual and financial reporting.

### 3. HIGH LEVEL SUMMARY OF THE INTERNATIONAL <IR> FRAMEWORK

The framework consists of the fundamental concepts, seven guiding principles and the content elements.

The framework takes a principles-based approach and does not prescribe specific key performance indicators (KPIs) or the disclosure of individual matters.<sup>12</sup>

The key aspect of <IR> is to connect material information for users to show how value is created over time. An integrated report should be a designated, identifiable communication, and not just be a summary of information presented elsewhere.

### THE FUNDAMENTAL CONCEPTS

<IR> aims to provide insight into the resources and relationships used and affected by an organisation, which it calls the 'capitals'.

**CAPITALS** Stocks of value on which all organisations depend for their success as inputs to their business model, and which are increased, decreased or transformed through the organisation's business activities and outputs.11

The framework categorises capitals into six categories:

- Financial
- Manufactured
- Intellectual
- Human
- Social and relationship
- Natural

These are only a guide and organisations may categorise the capitals differently or not even refer to them specifically, but they are intended to give an indication of the broad range of factors to be considered.

<IR> also seeks to explain how the organisation interacts with the external environment and the capitals to create value over the short, medium and long term.

VALUE CREATION The process that results in increases, decreases or transformations of the capitals caused by the organisation's business activities and outputs.11

When preparing an integrated report consider the 'value creation process', which encompasses the business model, vision and governance. Information should be provided about the value created both for the organisation itself and for others.

### **GUIDING PRINCIPLES<sup>13</sup>**

The following guiding principles underpin the preparation of an integrated report, informing the content of the report and how information is presented:

- Strategic focus and future orientation: An integrated report should provide insight into the organisation's strategy, and how it relates to the organisation's ability to create value in the short, medium and long term, and to its use of and effects on the capitals
- Connectivity of information: An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organisation's ability to create value over time
- Stakeholder relationships: 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
- Materiality: An integrated report should disclose information about matters that substantively affect the organisation's ability to create value over the short, medium and long term
- Conciseness: An integrated report should be concise
- Reliability and completeness: An integrated report should include all material matters, both positive and negative, in a balanced way and without material error
- Consistency and comparability: The information in an integrated report should be presented on a basis that is consistent over time; and in a way that enables comparison with other organisations to the extent it is material to the organisation's own ability to create value over time.

<sup>11.</sup> The International <IR> Framework, The IIRC, December 2013, p33

<sup>12.</sup> The International <IR> Framework, The IIRC, December 2013, p7

<sup>13.</sup> The International <IR> Framework, The IIRC, December 2013, p5

### **CONTENT ELEMENTS<sup>14</sup>**

An integrated report should include eight content elements. They are fundamentally linked to each other and are not mutually exclusive:

- Organisational overview and external environment: What does the organisation do and what are the circumstances under which it operates?
- Governance: How does the organisation's governance structure support its ability to create value in the short, medium and long term?
- Business model: What is the organisation's business model?
- Risks and opportunities: 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?
- Strategy and resource allocation: Where does the organisation want to go and how does it intend to get there?
- **Performance:** 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?
- Outlook: 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?
- Basis of presentation: How does the organisation determine what matters to include in the integrated report and how are such matters quantified or evaluated?

### **Determining materiality**

The determination of materiality for <IR> is an area which requires specific focus. An integrated report needs to disclose how an organisation has determined the matters to be included and how such matters have been quantified or evaluated. While the application of materiality is clearly understood from a financial reporting context, the application of materiality for non-financial information remains a challenge for many organisations, and will be a matter of judgement given the specific circumstances of an organisation. For example, certain matters might be material to one group of stakeholders but not to another.

For the purposes of <IR>, a matter is material if it is of such relevance and importance that it could substantively influence the assessments of providers of financial capital with regard to the organisation's ability to create value over the short, medium and long term.<sup>15</sup> In determining whether or not a matter is material, senior management and those charged with governance should consider whether the matter substantively affects, or has the potential to substantively affect, the organisation's strategy, its business model, or one or more of the capitals it uses or affects.

Materiality plays a crucial role in determining the matters to be included in an integrated report and ensuring conciseness of the report. Materiality and conciseness form two of the seven guiding principles that inform the content and presentation of an integrated report, as well as the process through which it is prepared.

In February 2014, the Australian Accounting Standards Board (AASB) released a Staff Paper: To Disclose or Not to Disclose: Materiality is the Question<sup>16</sup>. Although this was in a financial reporting context, it has relevance here. It states that:

One significant part of the solution is for preparers to not disclose immaterial and therefore unnecessary information.

The AASB paper further states that:

Items are considered to be material if their omission or misstatement, individually or collectively, could influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, is therefore the determining factor.

In order for integrated reports to meet the 'concise' principle, those responsible for their preparation will need to apply their judgement to ensure only relevant and material information is included. Organisations may also find it helpful to use their website to report other information which meets the needs of particular stakeholders without cluttering their integrated report. NAB addresses this issue through their 'Dig Deeper papers', a series of web-based reports providing greater detail in each of their corporate responsibility commitment areas.

<sup>14.</sup> The International <IR> Framework, The IIRC, December 2013, p5

<sup>15.</sup> Materiality - background paper for <IR> by AICPA

<sup>16.</sup> http://www.aasb.gov.au/admin/file/content102/c3/RCSP\_2-14\_Disclosure\_and\_Materiality.pdf, sourced 24 April 2014

### 4. HOW DO ORGANISATIONS MOVE TOWARDS <IR>?

A major misconception around <IR> is the perception that an integrated report must be produced within the first reporting cycle after an organisation has decided to adopt this new approach to reporting. This is not the case. For many organisations it will be a journey towards <IR>, with steps taken towards <IR> each reporting cycle. It is fair to say that even amongst those companies in South Africa and elsewhere around the world who have been on the journey for some time, that it is still too early to expect to see a perfect example of an integrated report.

### STOCKLAND

'For Stockland integrated reporting is a journey toward more meaningful corporate reporting and will be a process of continuous improvement, one that will provide great benefit to both the organisation and our stakeholders. We look forward to further developing our approach and the quality of our integrated report disclosure over the coming years."17

An integrated report may be prepared in response to existing compliance requirements, and may be either a standalone report (although it could be called something else) or be included as a distinguishable, prominent and accessible part of another report or communication.<sup>18</sup>

### KPMG EXPLAINS THE <IR> JOURNEY IN THE **FOLLOWING STEPS:**

The journey to improved communication with the capital markets begins firstly by improving and consolidating what is already reported.

The next step in the journey aims to overcome the limitations of today's reporting model by then incorporating forward-looking, strategic key performance indicators, and using management commentary as an opportunity to bring this together.

The end game is the development of a 'flagship' business report that fully integrates critical business performance information, traditional financial reporting, management commentary and sustainability reporting to allow external analysts, investors and others to make informed judgements about the entity's prospects.<sup>19</sup>

The following are ten practical steps towards <IR>20 to help organisations begin their journey.

### Preparing for <IR>:

- Start collecting and disclosing material information on the six capitals
- Assess the adequacy of the stakeholder engagement processes.

### Achieving buy-in

- Senior management buy-in
- Board buy-in
- Agreement on the reporting package. Start by including elements of <IR> at the front of your annual review or consider removing some non-material information from the annual report. Consider putting this information on the company's website or through another communication channel instead.

### Developing integrated thinking

- Determine material issues (refer section 3), engage both stakeholders and your senior management team
- · Reach agreement on your business model
- Develop your 'value creation story.' A value creation story should consider the six capitals and connect with your business model
- Articulate your strategy in a way that connects with your value creation story
- Connectivity of information, both within your integrated report and across other reports and communications.

Development of integrated thinking is an iterative process and reporting will help identify the gaps in the thinking.

<sup>17.</sup> Stockland Annual Review 2013, p2

<sup>18.</sup> The International <IR> Framework, The IIRC, December 2013, p4

<sup>19.</sup> KPMG, The Journey to better business reporting, 2010, p1

<sup>20.</sup> Dr Carol Adams CA, blog posted 12 December 2013, http://drcaroladams.net/ten-steps-to-integrated-reporting, sourced 13 January 2014

### 5. WHO'S DOING IT?

There is no single perfect example of an integrated report, but many organisations around the world have started their journey. There are now over 100 pilot companies formally participating in the IIRC's Pilot Programme. Australian companies in the pilot include:

- Stockland
- NAB
- Bankmecu
- Slater and Gordon.

Other companies in the region include New Zealand Post Group and China Light and Power as well as global companies BASF, Danone, HSBC, Marks and Spencer, Microsoft, SAP and Unilever.21

New Zealand Post and the National Australia Bank are amongst these pilot organisations.

### **NEW ZEALAND POST**

Mark Yeoman, Chief Financial Officer, explained the benefits of the Integrated Reporting approach adopted in its 2013 Annual Review:

'A typical Annual Report is focused on describing business activities, and presenting quite a technical financial perspective of an organisation. The new integrated report is much more accessible. It makes it easier for people to get a more complete picture of our business, including the important non-financial dimensions such as our people, relationships and environment which are not typically reflected in the traditional balance sheet.'22

It is worth noting that many companies that are already leading reporters display strong consistency with IR principles, whether or not they ascribe to the framework. Further, other organisations are starting their journey towards <IR> or better business reporting in their own way.

The IIRC has created and continues to add to the Emerging <IR> Database<sup>23</sup> of reporting examples from pilot companies and others around the world. The database provides examples of the guiding principles and the content elements to help organisations that are developing or planning to develop an integrated report.

NAB listed some benefits of integrated reporting as:

- Better illustration of the company and how culture and corporate responsibility are a fundamental part of how we do business
- Clearer ability to articulate how value is created in a sustainable manner for our stakeholders by bringing together material information about the operating environment, business strategy, governance, financial and non-financial performance in one report
- One integrated report helps shareholders and broader stakeholders find the information they require to meaningfully assess performance and understand the business model and strategy
- One integrated report enables more effective reporting and efficient use of resources.<sup>24</sup>

<sup>21.</sup> http://www.theiirc.org/companies-and-investors/pilot-programme-business-network, accessed 8 April 2014

<sup>22.</sup> http://www.theiirc.org/2013/12/16/new-zealand-post-new-zealand-postal-services, sourced 8 January 2014

<sup>23.</sup> http://examples.theiirc.org/home, sourced 9 January 2014

<sup>24.</sup> http://cr.nab.com.au/how-we-work/integrated-reporting, sourced 8 January 2014

# Part B – The role of the audit committee and board in <IR>

THOSE CHARGED WITH GOVERNANCE The person(s) or organisation(s) (e.g., the board of directors or a corporate trustee) with responsibility for overseeing the strategic direction of an organisation and its obligations with respect to accountability and stewardship.25

### 6. THE ROLE OF THE AUDIT COMMITTEE IN <IR>

The role of the audit committee has expanded beyond the financial information and now extends to examining nonfinancial information as well. This expanded role was recognised in the third edition of the ASX Corporate Governance Principles and Recommendations, where all references to financial reporting were replaced with corporate reporting, in recognition of increasing non-financial disclosure. In an EY survey from April 2014 a majority of investors felt that it was important or essential to have a level of accountability, whether in the form of audit committee oversight of sustainability data, oversight from the board or shareholder approval <sup>26</sup>. If an organisation decides to begin its journey towards <IR>, the audit committee will need to be involved at critical steps along the journey.

An integrated report should include a statement from those charged with governance that includes: 27

- Acknowledgements of their responsibility of 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 as to whether it is presented in accordance with the International <IR> Framework.

If the statement cannot be included, then the report should at least explain the involvement of those charged with governance and the steps and time frame towards including such a statement.

Those charged with governance have various and critical roles to play in relation to <IR> within an organisation. This would include for example:

- Determination of materiality ordinarily, matters related to value creation that are discussed at meetings of those charged with governance are considered relevant
- Creating an appropriate oversight structure to support the ability of the organisation to create value
- Oversight of the information flows in relation to the data sources for <IR>.

The International <IR> framework states that the 'quantitative indicators in an integrated report [are] to be consistent with the indicators used internally by those charged with governance'. Further, 'aligning external reporting with internal reporting by considering the top level of information that is regularly reported to those charged with governance is ordinarily appropriate.'

Therefore, the issues which are material for <IR> will be aligned to those that are important to the audit committee and board. These issues will go beyond the financial performance of the organisation. Significant and material issues will affect, or be affected by, the organisation's strategy and its business model. These issues are material impacts on the organisation, stakeholders, and society that the organisation must address and communicate clearly and concisely to external audiences.<sup>28</sup>

To determine them, the collective mind of the governing body and management will need to be applied to focus on those significant and few issues that really matter. This is done in respect to the legitimate and reasonable needs, interests, and expectations of the organisation and its stakeholders. As Professor Mervyn King, chair of the IIRC, puts it, 'In making a decision on behalf of the organisation, while taking account of these expectations, the governing body is guided by the principle of acting in the best interests of the company for the maximisation of the total value of the company'. 29

### 7. QUESTIONS FOR AUDIT COMMITTEES AND BOARDS TO ASK OF MANAGEMENT

The following questions have been framed around a separate standalone integrated report, however they can equally apply to <IR> data included within an existing report.

### DATA COLLECTION

- 1. How has the data been collected?
- 2. What controls exist over the systems/processes for the data collection?
- 3. How timely is the data, when was it collected?
- 4. What estimates have been used?

### REPORT PREPARATION

- 5. Who has prepared the integrated report?
- 6. Who has responsibility for the report within management?
- 7. Is the report preparation process robust?
- 8. What are the reporting boundaries for the integrated report and how do they differ to the financial report?

<sup>25.</sup> The International <IR> Framework, The IIRC, December 2013, p33

<sup>26.</sup> www.ey.com/Publication/vwLUAssets/EY-Institutional-Investor-Survey/\$FILE/EY-Institutional-Investor-Survey.pdf, sourced 7 April 2014

<sup>27.</sup> The International <IR> Framework, The IIRC, December 2013, p9

<sup>28.</sup> www.ifac.org/global-knowledge-gateway/business-reporting/focus-what-really-matters-key-trends-sustainability-an-0

<sup>29.</sup> www.icgl.org.au/professor-mervyn-king

### MATERIALITY

- 9. How has materiality been determined in the report, for both financial and non-financial information?
- 10. Were there other alternatives to the materiality definition especially for non-financial information?
- 11. What information has been left out of the report as a result of the application the of materiality definition?

### **DISCLOSURES**

- 12. Are the disclosures around the key content elements, such as strategy, future orientation and business model consistent with other information presented to the board?
- 13. How have the qualitative disclosures been supported?

- 14. Who within management has reviewed the report?
- 15. Is management aligned with the contents of the report? How has this been achieved and have they signed off?
- 16. Is the report consistent with the other information, both financial and non-financial, that the company discloses?
- 17. Is the report complete, based on the directors' knowledge of the organisation?

Section 9 covers assurance and the relevant issues the audit committee will need to consider.

### 8. WHAT ARE THE CHALLENGES?

The following are some common questions that have been expressed by directors and organisations regarding the adoption of <IR>:

- How will it impact directors' liability?
- How does <IR> fit with existing reporting requirements?
- Is there demand from investors?
- Will it be mandatory?
- Will <IR> need increased resources?
- Do we need to obtain assurance?

These questions are addressed in turn below and the final question on assurance is addressed in section 9.

### (A) DIRECTOR LIABILITY IN RESPECT OF FORWARD LOOKING STATEMENTS

In the guiding principles outlined in the framework, there is reference to the disclosure of an organisation's strategic focus and future orientation within the integrated report. Following the global consultation, respondents, particularly from Australia, highlighted concerns regarding director liability in respect of this principle. It is important to note that s299A(1) of The Corporations Act (2001) in Australia already requires the disclosure of information around future prospects or long-term value creation.

Under s299A(1), a listed entity's directors' report must contain information that members would reasonably require to make an informed assessment of an entity's operations, financial position and business strategies, including prospects for future financial years. In Australia, the Australian Securities and Investments Commission (ASIC) released Regulatory Guide 247 (RG 247)30 in March 2013 which provides guidance on effective disclosure in an operating and financial review (OFR). RG 247 further clarifies the requirement of s299A(1) as follows:31

Information on business strategies, and prospects for future financial years, should focus on what may affect the future financial performance and position of the entity. To satisfy this requirement, an entity may need to bring together some aspects of its past continuous disclosure announcements. Unless an entity is relying on the exemption for unreasonable prejudice in s299A(3), the OFR should describe:

- The overall business strategies relevant to the entity's future financial position and performance;
- The entity's prospects in terms of future financial performance and financial outcomes; and
- The material business risks that could adversely affect the achievement of the financial performance or financial outcomes described.

If an entity intends to rely on the unreasonable prejudice exemption to omit information, the basis for relying on the exemption needs to be carefully evaluated and established.

In New Zealand there is no current requirement for directors to make forward looking statements.

[NAB, bankmecu and Stockland all] said that their integrated reports are signed off at board level and that at all three organisations, board directors and senior executive management are comfortable that the forward-looking statements they are making in the integrated report are consistent with other public and statutory disclosures. None expressed concern about potential legal liabilities.<sup>32</sup>

It is important to note that an integrated report does not require the inclusion of profit or other forecast data.

<sup>30.</sup> Regulatory guide 247 Effective disclosure in an operating and financial review, ASIC March 2013

<sup>31.</sup> Regulatory guide 247 Effective disclosure in an operating and financial review, ASIC March 2013 p17

<sup>32.</sup> www.thesustainabilityreport.com.au/nab-bankmecu-stockland-on-integrated-reporting-framework/4543, sourced 29 January 2014

### (B) HOW DOES <IR> FIT WITH THE EXISTING REPORTING REQUIREMENTS?

### Australian environment

For Australian listed entities, the existing requirement for an OFR could represent a starting point for <IR>, as there is overlap between the OFR and <IR>. Critically, both have a focus on strategy and future orientation. As noted above, future orientation is the one aspect of <IR> which has caused some concern with directors, although it is a requirement of the OFR. Further, both have the same primary audience, the providers of financial capital or shareholders, and cover the value creation process. RG 247 focuses on value in terms of financial returns to shareholders whereas value in <IR> is broader across the six capitals. The <IR> guiding principles are covered with the exception of stakeholder relationships, but this will often be relevant in discussion of key risks (including environmental and sustainability risks as proposed by RG 247). There is also not a specific focus on connectivity of information in the way there is in <IR>. However, connectivity would be compatible with the intent of RG 247.

Further the main aspects of the content elements are included with the exception of governance, which is covered separately in the Corporations Act and the basis of presentation. While the OFR does not consider the external environment explicitly, it will be implicit in a discussion of strategies, risks and future prospects.

The Appendix to this guide includes a table analysing the <IR> principles and elements against RG 247.

The ASX Corporate Governance Council Principles and Recommendations set out recommended corporate governance practices for listed entities. They are required to report on an 'if not, why not' basis as to whether they have adopted each of the Principles and Recommendations. While the Principles and Recommendations do not refer specifically to <IR>, Principle 4 Safeguard integrity in corporate reporting would apply if a listed entity prepares an integrated report. Principle 4 requires a listed entity to have formal and rigorous processes that independently verify and safeguard the integrity of its corporate reporting.

Recommendation 7.4 states a listed entity should disclose whether it has any material exposure to economic, environmental and social sustainability risks and it manages those risks. In the commentary to this recommendation, it is noted there is increasing demand from investors for greater transparency on these matters to allow them to better assess risk.

### New Zealand environment

There is no New Zealand equivalent to the OFR. All New Zealand companies registered as foreign companies with ASIC are required to file financial statements with ASIC every year.

New Zealand listed companies are required to comply with the NZX Listing rules and to consider the NZX Corporate Governance Best Practice Code ('Code'). Although compliance with the Code is not mandatory, listed companies are required to disclose in the annual report whether the corporate governance principles adopted differ materially from those set out in the Code.

In addition Corporate Governance in New Zealand Principles, A Handbook for Directors, Executives and Advisers and Guidelines<sup>33</sup> set out nine principles of corporate governance. As with the Code, compliance with the principles is not mandatory. The principles recommend an organisation's website should include commentary on goals, strategies and performance as well as policies on stakeholder relationships. Further details of the principles as they relate to IR are included in the Appendix to this document.

### (C) DEMAND FROM INVESTORS

Evidence of investor demand for enhanced reporting can be seen through the 35 investors who have signed up to the pilot network, including six from Australia:

- Australian Council of Superannuation Investors ('ACSI')\*
- AMP Capital Investors
- Colonial First State Global Asset Management
- Financial Services Council
- Regnan Governance Research and Engagement\*
- Victorian Funds Management Corporation.
- \* These groups represent coalitions of investors, thus are involved on behalf of large groups of investors

Further evidence can also be found through the additional insights into an organisation's performance and strategy, which are currently included in analyst presentations.

### (D) WILL IT BE MANDATORY?

An integrated report may be prepared in response to existing compliance requirements, as we have seen in South Africa through the requirements of the King Code of Governance Principles for SA (King III Code). After being incorporated into the Johannesburg Stock Exchange Listing Requirements, King III requires listed companies to issue an integrated report or explain why they are not doing so. It is not however the aim of the IIRC to see <IR> mandated, with voluntary adoption of <IR> preferred. As noted earlier, the OFR is mandated in Australia although the content of RG 247 is merely a guide and not an additional compliance requirement.

### (E) WILL <IR> NEED INCREASED RESOURCES?

Many concerns of organisations considering <IR> relate to increasing the burden of reporting and adding to the volume of information. However, the key purpose of <IR> is to report more effectively and concisely. <IR> provides directors and management with an opportunity to take a new lens to their existing suite of corporate communications by focusing on those matters material to an organisation's strategy and performance. There is also an opportunity for organisations to consider how their existing reporting, such as the OFR, can be enhanced to better align with <IR>.

Working out what is in and what is out - moving from a 40-100 page sustainability report to a 30-40 page integrated report requires a robust materiality process, cooperation and focus! Janette O'Neill, Head of Corporate Responsibility Strategy, NAB

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### 9. RELIABILITY, CREDIBILITY AND ASSURANCE

### ARE AUDITORS REQUIRED TO CONSIDER AN INTEGRATED REPORT?

There is no requirement in the framework for assurance of an integrated report or over <IR>. In response to the consultation, the majority of submissions to the IIRC supported the notion that if assurance is to be obtained, that it should cover the entire report.<sup>34</sup> Credibility and connectivity were cited as the primary reasons for assuring the report. However, the details of what and how assurance should be provided was deemed to be beyond the scope of the framework and best worked through by the assurance standard setters such as the International Auditing and Assurance Standards Board (IAASB). Further, analysis undertaken by the Association of Chartered Certified Accountants (ACCA) identified that 80% of investors felt that non-financial disclosures should be independently verified.<sup>35</sup>

Should the contents of an integrated report come under 'other information', as defined within the auditing standards, which would be possible if the information is incorporated in an Annual Report, then the financial statement external auditor would be required to read it as part of their statutory audit engagement. They would need to check that there were no material inconsistencies with the audited financial statements and no misstatements of facts known to them from their audit work. No report would be given over the integrated report.

Although there is no requirement for an assurance opinion over the integrated report, the framework recognises that reliability

is enhanced by mechanisms such as robust internal control and reporting systems, stakeholder engagement, internal audit and independent external assurance. For many organisations assurance of their integrated report will form part of their <IR> journey.

The Institute of Chartered Accountants Australia began reporting in line with its Broad Based Business Reporting (BBBR) framework in 2009. In 2011, when the processes and controls around the production of its BBBR report were better established, the Institute sought assurance from its external auditor over the front half of the annual report. A limited assurance engagement was performed, in accordance with ASAE 3000: Assurance Engagements other than Audits or review of Historical Financial Information (see page 16).

As well as assisting an entity and its directors in relation to reliability, assurance can also add to the credibility of information in the eyes of the user.

When considering whether assurance is relevant, directors first have to understand whether assurance is possible. This requires the entity to have an appropriate basis for reporting. Directors will need to understand the processes and controls in place to collate and report the information included within the integrated report. Further, they will need to consider the completeness and reliability of the information in the report and the linkage of information, both within the report and to other reports and disclosures.

### BENEFITS OF ASSURANCE OVER NON-FINANCIAL INFORMATION

As noted above, assurance will enhance the integrity and credibility of reports and enhance the confidence that can be placed on those reports for decision-making purposes.

The assurance process, having the auditors seeking evidence on both finance and strategy/communications information, can strengthen the project management and engagement between those in finance maintaining the general ledger and those preparing information and writing the full report.

Experiences and learnings of assurance over the non-financial information can include:

- Improvement in the processes and controls for the collection of non-financial information/data
- The creation of robust version control during the development of the final report through to sign-off
- Clarification between information based on facts and that which is more opinion based and their respective presentations. For example, while the Chair and CEO Reports are based on fact, they are more in line with 'opinion', and so may not included in the assurance engagement

<sup>34.</sup> www.theiirc.org/wp-content/uploads/2013/12/13-12-08-Summary-of-significant-issues-IR.pdf, p42, sourced 13 January 2014

<sup>35.</sup> What do investors expect from non-financial reporting?, ACCA and Eurosif, 2013

- Clear articulation of KPIs/performance measures for approval by the Board prior to the writing of the report
- Greater relevance and engagement to stakeholders through a review of performance targets and how they are reported
- Greater focus on evidence-based narrative, both in the report and in other communication and marketing material produced by the organisation
- A clear, identifiable body of information/data, which can be easily updated annually
- Greater engagement from the board with the overall reporting process.

### REASONABLE OR LIMITED ASSURANCE?

Reasonable assurance means that the auditor has collected sufficient evidence to state that in their opinion the information is not materially misstated.

Limited assurance provides a lower level of assurance, with the auditor stating that nothing has come to their attention which indicates the information is materially misstated.

Some organisations may use a combination of reasonable and limited assurance, identifying the information and processes each relates to, for example SAP AG in 2012.36

### WHO SHOULD PROVIDE ASSURANCE?

Members of the audit committee, and directors more broadly, play a role in engaging the assurance provider and therefore need to be aware of what to look for in an assurance provider, as well as the standards governing assurance of <IR> information.

Assurance engagements for <IR> can be carried out by both the accounting profession and the non-accounting profession. However, it is important that your assurance provider is independent and has no involvement in the developing the collection, measurement or presentation of the information included in <IR>. The Institute found benefit in using its external auditor for the assurance engagement.

Your organisation has a choice about their assurance provider, but it is advisable that:

- It is carried out by a multidisciplinary team combining assurance experience with expertise specific to your operations
- The team is led by a person particularly experienced in assurance and in running multi-disciplinary teams
- You are satisfied as to the professional competence and codes of conduct governing the assurance provider's work.

The team should also use an appropriate assurance standard. In 2003, the International Auditing and Assurance Standards Board (IAASB) issued ISAE 3000: Assurance Engagements Other than Audits or Reviews of Historical Financial Information, a general standard for assurance of non-financial information; this was revised in 2008. Its Australian counterpart is ASAE 3000 and ISA (NZ) 3000 in New Zealand.

The Institute issued an audit committee guide on *The benefits* of assuring greenhouse gas emissions. While this covers guidance specific to such information, some of the concepts and ideas can be applied to other non-financial information which may be included in the integrated report.

### 10. CONCLUSION

The release of the International <IR> Framework in December 2013 has enabled organisations to fully understand the principles and concepts in the framework. As this guide highlights, <IR> is a journey for many organisations. Steps can be taken towards <IR> without needing to meet all aspects of the framework at the start of the process. Pilot companies are seeing benefits from their integrated report and the changes to internal processes that have evolved as a result. Further, investors are becoming increasingly involved in the global discussion around broader business reporting and <IR> in particular.

Additionally, it is critical for the audit committee and directors to be involved at various steps along the journey. Amendments to the ASX Corporate Governance Principles in Australia confirm that audit committee oversight extends across the broad range of corporate reporting and is not restricted to pure financial reporting. This guide looks at some of the challenges organisations and their board and audit committee may face in relation to <IR> and how these can be effectively managed. Further it covers assurance of <IR> and helps organisations determine when they should seek assurance over the process.

We expect guidance and practical experiences of <IR> to continue to develop and evolve as more organisations begin to adopt the framework. In this context, we will look to revise this guide in the future to reflect the changing environment in Australia and New Zealand.

# **Appendix**

## 1. DETAILED COMPARISON OF <IR> KEY PRINCIPLES TO RG 247

In the tables below, we have mapped the <IR> key principles and elements to the RG 247 requirements to see the similarities and differences.

<ir> FUNDAMENTAL CONCEPTS</ir>	RG 247 REFERENCES	COMMENTS
Audience is providers of financial capital	Shareholders	There is overlap here as shareholders are providers of financial capital although <ir> extends beyond shareholders.</ir>
Capitals	63. An OFR should include a discussion of environmental and other sustainability risks	There is no discussion of the capitals in RG 247.
Value creation process	42. How the entity makes money and generates income of capital growth for shareholders.	RG 247 focus is on financial and manufactured capital compared to <ir> across the six capitals.</ir>

IR> GUIDING PRINCIPLES	RG 247 REFERENCES	COMMENTS	
Strategic focus and future orientation	27c) Overview of the entity's business strategies and prospects for future financial years.	The <ir> Framework includes specific reference to the capitals and value creation.</ir>	
Connectivity of information	81. Table 3. Single self-contained section.  Complementary and consistent information.	The <ir> Framework connectivity is around the interdependencies between key factors whilst RG 247 is focused on all information presented in the same place.</ir>	
Stakeholder relationships		There is no discussion around stakeholder relationships in RG 247.	
Materiality	61. 'Material business risks' – most significant areas of uncertainty or exposure	The OFR should contain information that members would reasonably require – this could be viewed as similar to material information.	
Conciseness	<ul><li>27a) An OFR should concisely present key information</li><li>81. Table 3 clear, concise and effective presentation.</li></ul>	Whilst not a legislative requirement, RG 247 recommends conciseness.	
Reliability and completeness	<ul><li>61. Important that a discussion about future prospects is balanced.</li><li>81. Table 3. Balanced and unambiguous disclosure.</li></ul>	RG 247 also mentions that the OFR should be free from material misstatement, which aligns to the reliability principle.	
Consistency and comparability	81. Table 3. Complementary and consistent information.	RG 247 is focused on consistency with the financial report whilst <ir> Framework is around comparability over time.</ir>	

<ir> CONTENT ELEMENTS</ir>	RG 247 REFERENCES	COMMENTS
Organisational overview and external environment	41. A review of the operations that the entity undertakes.	RG 247 focuses on the financial aspects of operations such as revenue and expenses, whilst the <ir> Framework is broader around culture, competition and markets.</ir>
Governance		Governance disclosures are a separate requirement in the Corporations Act.
Business model	42. [Business] model should be clearly articulated.	In RG 247, this is included as part of the operational review.
Risks and opportunities	<ul><li>62. A discussion of the risks that could affect the entity's achievement of the financial prospects disclosed.</li><li>61. May be appropriate to disclose factors that could materially improve the financial prospects.</li></ul>	In RG 247, risks are part of the future prospects section and those connected to financial performance, sustainability and environmental are specifically mentioned. <ir> Framework also refers to opportunities.</ir>
Strategy and resource allocation	58. An OFR should outline the entity's key business strategies.	The <ir> Framework also includes resource allocation and strategic objectives.</ir>
Performance	43. Matters relevant to understanding an entity's performance.	RG 247 performance is focused on income and expenses.
Outlook	60. Discussion of entity's prospects for future financial years.	RG 247 is focused on financial performance and outcomes.
Basis of presentation		This is not specifically required in the OFR. However paragraph 76 requests that if information has been omitted, the OFR should disclose the fact and the reasons.

## 2. RELEVANT EXCERPTS FROM CORPORATE GOVERNANCE IN NEW ZEALAND PRINCIPLES, A HANDBOOK FOR DIRECTORS, **EXECUTIVES AND ADVISERS AND GUIDELINES**

Principle 4.2 of the corporate governance principles states: Annual reports of all entities should, in addition to all information required by law, include sufficient meaningful information to enable investors and stakeholders to be well informed on the affairs of the entity.

Principle 6 covers risk management and the securities commission's view is that the risks should include legal compliance, financial, operational, technological, and environmental risks.

Principle 8 on shareholder relations states that publicly owned entities should maintain an up-to-date website, providing:

- A comprehensive description of its business and structure;
- A commentary on goals, strategies and performance; and
- Key corporate governance documents;

∠IR~ CONTENT ELEMENTS

RC 247 REFERENCES

• All information released to the stock exchange (for listed entities), including reports to shareholders.

Principle 9 on stakeholder interests states that entities should have policies for relationships with key stakeholders and the board should regularly assess compliance with these policies to ensure that conduct towards stakeholders complies with the code of ethics and the law and is within broadly accepted social, environmental, and ethical norms, generally subject to the interests of shareholders. The Commission's view further notes that:

COMMENTS

There is a trend for listed companies to report on how they have affected their stakeholders.

# References/useful links

ICAA IR	http://www.charteredaccountants.com.au/Industry-Topics/Sustainability/Integrated-reporting.aspx
ICAA annual report	http://www.charteredaccountants.com.au/The-Institute/Who-we-are-and-what-we-do/News-and-updates/News/Annual-Report-2013
IIRC website and papers	http://www.theiirc.org
Emerging Integrated Reporting Database	http://examples.theiirc.org/home
IFAC organisational reporting policy position	http://www.ifac.org/publications-resources/enhancing-organizational-reporting
IFAC knowledge gateway IR	http://www.ifac.org/global-knowledge-gateway/business-reporting
NZICA article	https://www.nzica.com/News/Archive/2013/October/Going-downthe-integrated-reporting-path.aspx
Business Reporting Leaders Forum	http://www.ske.org.au/BRLF.php
ASIC RG 247	https://www.asic.gov.au/asic/asic.nsf/byheadline/Regulatory+Guide+247+Effective+disclosure+in+an+operating+and+financial+review?openDocument
ASX corporate governance principles	http://www.asx.com.au/regulation/corporate-governance-council/review-and-submissions.htm
NZ corporate governance	http://www.fma.govt.nz/keep-updated/reports-and-papers/handbook-corporate-governance-in-nz-principles-and-guidelines

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