



Australian Government

Auditing and Assurance Standards Board

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15 July 2013

Professor Mervyn King
Chairman
International Integrated Reporting Council
Uploaded to: <http://www.theiirc.org/consultationdraft2013/feedback/>

Dear Professor King,

AUASB Submission on Consultation Draft of the International <IR> Framework

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to have the opportunity to comment on assurance matters arising from the IIRC *Consultation Draft of the International <IR> Framework*.

The AUASB supports the IIRC's initiative to consider Integrated Reporting as a reporting framework in which reporting entities can communicate their value creation proposition in a more cohesive way to the wider capital markets. Exploring options that may help achieve reporting that better meets the information needs of users is clearly in the public interest.

In formulating its response, the AUASB sought input from its constituents through a "roundtable" discussion on assurance related matters attended by twenty five stakeholders from a broad range of backgrounds, including audit firms, assurance providers, regulators, professional accounting bodies, board members and executives. In addition, the AUASB also attended a number of technical sessions on the <IR> Framework that were undertaken by the IIRC staff in Melbourne in June 2013.

Our responses to the specific questions raised in the Consultation Paper are presented so as to articulate the views of these stakeholders where appropriate.

There are a number of key matters which the AUASB encourages the IIRC to further consider in finalising the <IR> Framework:

- Overall, the AUASB believes that the content of the draft <IR> Framework is an appropriate context in which an entity can frame its value creation proposition in the short, medium and long term. The six capitals provide a benchmark coupled with the business model to explain how an entity creates value over time. The AUASB supports a principles based framework which has core elements and a defined reporting process.
- However the <IR> Framework is quite general and non-specific around what is required to be reported in relation to the six capitals and therefore could lead to more information rather than quality information being reported. This would not support the IIRC's objective of the integrated report remaining relevant and concise to providers of capital. In this sense the framework could be made simpler if more specificity or relevant examples were given to preparers.



- Materiality continues to be an area open for interpretation under the framework, noting also that some of the suggested disclosure requirements in relation to materiality seem to be quite onerous.
- In order to adequately assess whether the guiding principles and content elements of the proposed integrated reporting framework would meet the suitability of criteria test currently required under the International Assurance Framework, the IIRC may consider co-ordinating an integrated reporting assurance pilot for volunteer entities to exist in parallel with the integrated reporting pilot program, which would leverage from the work being done by the IIRC Assurance Technical Collaboration Group. The objective for the pilot would be to test the framework's ability to be assured as may be required by users and preparers of the integrated report.
- It would be important in local jurisdictions to consider how financial reporting and integrated reporting will interplay and whether an efficient process for producing an integrated report can be found. Currently in Australia completing an integrated report under the proposed framework would create an additional layer of reporting that may link to other reports produced by an entity. The Operating and Financial Review (OFR) section of the annual report is currently used to meet local reporting requirements with regard to an entity's strategic positioning for the short, medium and long term. A number of attendees thought that the OFR could be used as a vehicle for entities to adopt more integrated reporting in the shorter term.
- Notwithstanding this, the OFR disclosures are currently not required to be audited or reviewed in Australia. However the auditor of the entity would read the other information provided by management to identify any inconsistencies between the OFR and the other information within the financial report.
- As integrated reporting evolves, in the longer term it may be possible that an integrated report would subsume the OFR requirements in Australia and the integrated report or parts thereof may be assured as required by *Those Charged With Governance* (TCWG) or the users of the integrated report. It is also important to understand that it is TCWG and management's responsibility to define the process and key measures and criteria against which the assurance practitioner will base their opinion or conclusion on an integrated report. It is not the assurance practitioner's role to establish the subject matter and the criteria.
- The Australian director community has raised the issue of directors' liability and their unwillingness to broaden the disclosure of an entity's value proposition and forward looking statements without a "hold harm" clause being in place. Where information is disclosed in good faith this should be considered by local jurisdictions in the context of their current legislative and regulatory environments. In parallel with this, traditionally assurance practitioners are less comfortable in opining on prospective information especially when it extends to the "long term" view of an entity.
- The *International <IR> Framework* should not be mandated in local jurisdictions as this may lead to boiler plate reporting and a tick box mentality reducing any value from the integrated report. Integrated reporting should be market driven. Some local jurisdictions may consider an "apply or explain" adoption with consideration of the cost and benefits from such a



decision. Assurance is likely to follow reporting and also be market driven and may cover all or part of the integrated report and consist of both audit and review levels of assurance.

The AUASB's responses to the specific questions raised in the CD of the *International <IR> Framework* in Attachment A have been submitted through the IIRC's online portal as requested.

Should you have any queries regarding this submission, please do not hesitate to contact either myself or Marina Michaelides, Senior Project Manager (mmichaelides@auasb.gov.au).

Yours sincerely,

Merran Kelsall
Chairman



Chapter 1: Overview

Principles-based requirements

To be in accordance with the Framework, an integrated report should comply with the principles-based requirements identified throughout the Framework in bold italic type (paragraphs 1.11-1.12).

1. Should any additional principles-based requirements be added or should any be eliminated or changed?

If so, please explain why.

The CD of the proposed integrated reporting framework is clear that it is principles-based and includes requirements that should be applied in order for entities to state they have complied with the integrated reporting framework.

Paragraph 1.11 and 1.10 allows for omission of data if reliable data is “unavailable” or will cause “competitive harm”. These notions will require significant guidance (more so than legal prohibition) and raise the question as to whether assurance practitioners should accept engagements in such circumstances, and if so, what disclosures should be made by entities and practitioners. For example, an *emphasis of matter* (EOM) approach may be required if adequate disclosure has been made by the entity.

Interaction with other reports and communications

The integrated reporting process is intended to be applied continuously to all relevant reports and communications, in addition to the preparation of an integrated report. The integrated report may include links to other reports and communications,

e.g. financial statements and sustainability reports. The IIRC aims to complement material developed by established reporting standard setters and others, and does not intend to develop duplicate content (paragraph 1.18-1.20).

2. Do you agree with how paragraphs 1.18-1.20 characterise the interaction with other reports and communications?

It would be important in local jurisdictions to consider how financial reporting and integrated reporting will interplay with each other to provide an efficient process for producing an integrated report. Currently in Australia completing an integrated report under the proposed framework would create an additional layer of reporting that may link to other reports produced by an entity. The Operating and Financial Reviews (OFR) section of the annual report is currently used to meet local reporting requirements with regard to an entity’s strategic positioning for the short, medium and long term. A number of attendees thought that the OFR could be used as a vehicle for entities to adopt more integrated thinking around their reporting in the shorter term.

Importantly, those pilot entities in the process of adopting integrated reporting see the reporting aspect as the outcome of a whole of business journey, rather than as an end in itself. As such, pilot entities already see the business benefits from integrated thinking, which comes from the journey before any useful reporting is produced.



Notwithstanding this, the OFR disclosures are currently not required to be audited or reviewed in Australia. However the auditor of the entity would read the other information provided by management to identify any inconsistencies between the OFR and the other information within the financial report.

As integrated reporting evolves, in the longer term it may be possible that an integrated report would subsume the OFR requirements in Australia and the integrated report or parts thereof may be assured as required by *Those Charged With Governance* (TCWG) or the users of the integrated report.

The AUASB acknowledges that there is already appropriate financial measurement and recognition frameworks in local jurisdictions and agrees that the integrated reporting principles based framework should not cover these areas.

However, the framework could provide greater clarity as to its fit beside financial reporting and the resultant assurance on both. If the integrated reporting framework is intended to be a standalone reporting framework as noted at *5G Reporting Boundary*, how can this be made operational in local reporting jurisdictions where local reporting requirements drive compliance in the capital markets?

3. If the IIRC were to create an online database of authoritative sources of indicators or measurement methods developed by established reporting standard setters and others, which references should be included?

Reference could be made to the Australian Accounting Standards Board (AASB) website (www.aasb.gov.au). The Australian Accounting Standards sets the financial measurement, recognition and disclosure standards adopted by Australian reporting entities.

Other

4. Please provide any other comments you have about Chapter 1.

The AUASB has no further comments on Chapter 1.

Chapter 2: Fundamental concepts

The Capitals (Section 2B)

The proposed Framework describes six categories of capital (paragraph 2.17). An organisation is to use these categories as a benchmark when preparing an integrated report (paragraphs 2.19-2.21), and should disclose the reason if it considers any of the Capitals as not material (paragraph 4.5).

5. Do you agree with this approach to the Capitals?

Yes in principle, the AUASB agrees that the capitals may be used as a benchmark of what could be included in an integrated report as long as entities are able to apply the materiality determination principle appropriately. The framework is quite general and non-specific around what is required to be reported in relation to the six capitals and therefore could lead to more information rather than quality information being reported. This is interlinked with the ability of the entity to apply the



materiality process effectively to ensure the report remains relevant, concise and credible to the market and in doing so supporting the IIRC's overall objective for an integrated report.

In this sense the framework could be made simpler if more specificity were given to preparers. In addition the inclusion of more working examples in relation to those requirements outlined in Chapter 4 *Content Elements* may be useful to those wanting to adopt the framework.

In line with this the framework also requires the entities to disclose their materiality determination process and who was part of that process. These requirements may be quite onerous on the entity and are not currently required by reporting entities under local reporting regimes.

With regard to materiality, entities may need to seek assistance in formulating their materiality determination process and to ensure that the completeness of their integrated report is maintained.

Attendees thought that a different term for capitals may be more readily accepted in the market place e.g. resources.

Why/why not?

To maintain the integrity and credibility of the report would seem appropriate that the entity disclose the reason why one of the capitals may not be material.

6. Please provide any other comments you have about Section 2B?

The AUASB has no further comments on Section 2B.

Business model (Section 2C)

A business model is defined as an organisation's chosen system of inputs, business activities, outputs and outcomes that aims to create value over the short, medium and long term (paragraph 2.26).

7. Do you agree with this definition? Why/why not?

Yes. It seems appropriate to extend the standard definition of business model to include outcomes which focuses the entity on wider implications than the standard outputs e.g. products etc.

8. Outcomes are defined as the internal and external consequences (positive and negative) for the capitals as a result of an organisation's business activities and outputs (paragraphs 2.35-2.36).

Do you agree with this definition? Why/why not?

Yes. It seems appropriate that some outcomes may be 'negative' in nature and disclosing this information give a more holistic view of the entity and how it is progressing in meeting its overall strategic objectives. This type of 'negative' reporting may be seen as more onerous by entities whose reporting under an annual report may be more optimistic.

As integrated reporting is adopted more broadly, it is likely that over time entities will become more comfortable with this type of reporting and assurance practitioners more comfortable in providing assurance where appropriate.



9. Please provide any other comments you have about Section 2C or the disclosure requirements and related guidance regarding business models contained in the Content Elements Chapter of the Framework (Section 4E).

Other

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

The AUASB has no further comments on Section 2C.

Chapter 3: Guiding Principles

Materiality and conciseness (Section 3D)

Materiality is determined by reference to assessments made by the primary intended report users (paragraphs 3.23- 3.24). The primary intended report users are providers of financial capital (paragraphs 1.6-1.8).

11. Do you agree with this approach to materiality? If not, how would you change it?

The definition of materiality as described at 3.23 of the framework CD is consistent with that applied in the International Financial Reporting Standards (IFRS) context in that it focuses on what those charged with governance see as relevant and reliable and those matters that could substantively influence the assessments of the primary intended report users.

This seems to be generally consistent with the accounting framework's definition of materiality. Assurance practitioners may also be able to provide a review of an entity's materiality determination or the process for determination of material matters to be included in an integrated report.

12. Please provide any other comments you have about Section 3D or the Materiality determination process (Section 5B).

As outlined in section 5B *The Materiality Determination Process*, the framework describes in detail what entities need to consider as part of their materiality determination process. In addition, at 5.13 *Disclosure*, it outlines the requirements for disclosure of an entity's materiality determination process. This includes describing the process used to identify relevant matters, identifying key personnel involved in the identification and prioritisation of material matters and identifying the role of those charged with governance.

This level of disclosure sets a high benchmark for entities around materiality. Currently, these types of disclosures are not generally required by reporting regimes nor are assurance practitioners asked to disclose materiality calculations in their independent reports for clients. Coupled with the "directors liability" issue raised by our board community in Australia this would be seen as quite onerous on entities.



Reliability and completeness (Section 3E)

Reliability is enhanced by mechanisms such as robust internal reporting systems, appropriate stakeholder engagement, and independent, external assurance (paragraph 3.31).

13. How should the reliability of an integrated report be demonstrated?

The reliability of an integrated report could be demonstrated at a number of different levels:

1. Statement by *those charged with governance* acknowledging their responsibility for the integrated report and the entity's processes that drive the integrated report.
2. Internal audit review or sign off of the processes that drive the integrated report.
3. External assurance provided on the process for preparation of the integrated report, narrative and metrics in the integrated report. The level of assurance (limited or reasonable) provided by the assurance practitioner may be different for each of these areas.

14. Please provide any other comments you have about Section 3E.

Section 3E reliability and completeness guiding principle requires an integrated report to “provide an unbiased view of the entity’s ability to create value....include all material matters, both positive and negative, without error”. This requirement is quite extensive and may not currently be required under financial reporting frameworks in local jurisdictions. Both management, TCWG and assurance practitioners may be uncomfortable with this broad framework of “full disclosure” from the perspective of disclosing their competitive advantage or disadvantage and liability concerns.

Over time, as the integrated report framework is more widely adopted, this issue of disclosure of competitive advantage may dissipate as the IIRC see a broader and higher level of take up of integrated reporting.

Other

15. Please provide any other comments you have about Chapter 3 that are not already addressed by your responses above.

The AUASB has no further comments on Chapter 3.

Chapter 4: Content Elements

16. Please provide any comments you have about Chapter 4 that are not already addressed by your responses above (please include comments on the Content Element Business Model [Section 4E] in your answer to questions 7-9 above rather than here).

Refer to AUASB comment under 2B re: Chapter 4.



Chapter 5: Preparation and presentation
Involvement of those charged with governance
(Section 5D)

Section 5D discusses the involvement of those charged with governance, and paragraph 4.5 requires organisations to disclose the governance body with oversight responsibility for integrated reporting.

17. Should there be a requirement for those charged with governance to include a statement acknowledging their responsibility for the integrated report?

Yes.

It is the responsibility of Those Charged With Governance's (TCWG) to set the content and boundaries for the integrated report and provide the users of the report with an attestation that the integrated report is reliable and the processes used to build the integrated report are reliable and complete.

It is important to understand that it is TCWG and management's responsibility to define the process and key measures and criteria against which the assurance practitioner will base their opinion or conclusion. It is not the assurance practitioner's role to establish the subject matter and the criteria.

18. Please provide any other comments you have about involvement of those charged with governance (Section 5D).

The AUASB have no further comments on Section 5D.

Credibility (Section 5E)

The framework provides reporting criteria against which organisations and assurance providers assess a report's adherence (paragraph 5.21).

19. If assurance is to be obtained, should it cover the integrated report as a whole, or specific aspects of the report? Why?

The attendees thought that integrated report users would ultimately like to see assurance across the whole of the integrated report. This may include external assurance over different areas of the integrated report and the processes in its preparation.

External assurance could be provided on the following:

- process for preparation of the integrated report
- narrative or qualitative data-sets
- metrics or quantitative measures in the integrated report

The proposed integrated reporting framework appears to provide adequate flexibility to allow the entity, the users and the assurance practitioner the ability to determine what type and level of assurance may be obtained and this is likely to be different for each engagement. There is no mandatory requirement for external assurance on any aspects of an integrated report as outlined very briefly under 5E Credibility paragraphs 5.19 and 5.20.



The level of assurance (limited or reasonable) provided by the assurance practitioner may be different for each of these areas. An issue raised by attendees was what would the audit or review report look like for an integrated report? Would it contain multiple opinions or conclusions within one independent auditor's report over the whole or part of the integrated report? Or would the reports be separated on the basis of the level of assurance provided? How useful and clear would this auditor's report be to the users of an integrated report? These issues should be pursued by the Assurance Technical Collaboration Group and any volunteer pilot entities.

There will also need to be a focus on cost-benefit to the users of the integrated report and this is likely to drive the levels of assurance. There may be a 'some' or 'all' assured decision by TCWG.

What must be taken into account in the discussion on assurance is the likely impact on director liability. The point being made in Australia is that directors more closely review the financial reports which attract a higher risk and which have a higher level of assurance as compared to a sustainability report which is seen as a lower risk report. In turn, an integrated report which discloses forward looking information and attestations by TCWG and management would be seen as higher risk for both directors and their assurance providers.

The Australian director community has raised the issue of directors' liability and their unwillingness to broaden the disclosure of an entity's value proposition and forward looking statements without a "hold harm" clause being in place. Where information is disclosed in good faith this should be considered by local jurisdictions in their current legislation and regulatory environments.

The participants of the AUASB's roundtable discussions found that it was difficult to assess whether the guiding principles and content elements of the proposed integrated reporting framework would meet the suitability of criteria test currently required under the International Assurance Framework. Participants thought that in order to assess this adequately, there may be the need for integrated reporting assurance pilot entities to exist in parallel with the integrated report pilot program. The proposed integrated reporting framework needs to be sufficiently robust to enable assurance over an appropriate subject matter measured against the framework criteria.

20. Please provide any other comments you have about Credibility (Section 5E). Assurance providers are particularly asked to comment on whether they consider the Framework provides suitable criteria for an assurance engagement.

The participants felt that forward looking statements, business strategy and future outlook are more challenging to assure, although evidence can be sought in the form of business plans, benchmarking, forecasting and justification of assumptions made within the process.

There is already some confusion regarding the level of assurance provided on financial reporting and a much greater potential exists to confuse report users in relation to assurance over an integrated report. Internationally in a paper produced by the Institute of Chartered Accountants Scotland (ICAS), *Balanced and Reasonable a discussion paper on the provision of positive assurance on management commentary*, there has been some discussion on the concept of "balanced and reasonable assurance" being provided on the management or narrative commentary in an annual and/or integrated report. Balanced and reasonable is described as a medium level of assurance, somewhere between an audit and a review.



The approach to assurance needs to be consistent with one robust assurance framework adopted across all assurance engagements. This would ensure terminology and meanings across the industry would be consistent. ISAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information is a widely adopted assurance standard that can be applied to a range of assurance engagements at both a reasonable and limited assurance level and is encapsulated under the International Framework for Assurance. Increasing the level of assurance over time for e.g. the sustainability arena – some boards may have engaged firms to perform agreed-upon procedures (AUPs) engagements initially until systems and controls were at an adequate level to obtain meaningful external assurance. Multi-faceted assurance teams with specialists in different capitals would add value and enhance the potential for consistency.

Materiality determination is at the core of a good integrated report and to achieving standardisation in assurance. Assurance providers should review the materiality determination process prepared by TCWG and management of the entity.

Section 3A Strategic focus and future orientation in an integrated report should provide insight into an organisation's strategy and future orientation – traditionally assurance practitioners are less comfortable in opining on prospective information especially when it extends to the “long term” view of an entity. This is very late to be raising the problems associated with the long term – including for TCWG.

This means that the scope of any assurance engagement under the proposed integrated reporting framework would need to be very clear and agreed by the entity and the assurance practitioner so all parties understand what type of report they will receive and the level of assurance that can be provided by the assurance practitioner.

Other

21. Please provide any other comments you have about Chapter 5 that are not already addressed by your responses above (please include comments on the materiality determination process [Section 5B] in your answer to question 11 above rather than here).

The AUASB has no further comments on the proposed integrated reporting framework.

Overall view

22. Recognising that integrated reporting will evolve over time, please explain the extent to which you believe the content of the Framework overall is appropriate for use by organisations in preparing an integrated report and for providing report users with information about an organisation's ability to create value in the short, medium and long term?

Overall, the AUASB believes that the content of the draft <IR> Framework is an appropriate context in which an entity can frame its value creation proposition in the short, medium and long term. The six capitals provide a benchmark coupled with the business model to explain how an entity creates value over time. The AUASB supports a principles based framework which has core elements and a defined reporting process.



However the <IR> Framework is quite general and non-specific around what is required to be reported in relation to the six capitals and therefore could lead to more information rather than quality information being reported. This would not support the IIRC's objective of the integrated report remaining relevant and concise to providers of capital. In this sense the framework could be made simpler if more specificity or relevant examples were given to preparers.

In order to adequately assess whether the guiding principles and content elements of the proposed integrated reporting framework would meet the suitability of criteria test currently required under the International Assurance Framework, the IIRC may consider co-ordinating an integrated reporting assurance pilot for volunteer entities to exist in parallel with the integrated reporting pilot program, which would leverage from the work being done by the IIRC Assurance Technical Collaboration Group. The objective for the pilot would be to test the framework's ability to be assured as may be required by users and preparers of the integrated report.

The Australian director community has raised the issue of directors' liability and their unwillingness to broaden the disclosure of an entity's value proposition and forward looking statements without a "hold harm" clause being in place. Where information is disclosed in good faith this should be considered by local jurisdictions in the context of their current legislative and regulatory environments. In parallel with this, traditionally assurance practitioners are less comfortable in opining on prospective information especially when it extends to the "long term" view of an entity.

Development of Integrated Reporting

23. If the IIRC were to develop explanatory material on integrated reporting in addition to the Framework, which three topics would you recommend be given priority? Why?

If the IIRC working groups complete their explanatory guides in the areas of connectivity and assurance this would assist in an entity's adoption of the proposed integrated report framework and provide relevant guidance for implementation.

In addition, the IIRC should continue its work in developing an example integrated report database. This would be useful for those entities embarking on adoption of the *International <IR> Framework* as well as assurance practitioners considering providing assurance on all or parts of the integrated report.