Business Reporting Leaders Forum (BRLF)

Responses to FRC Discussion Questions at meeting on 1 May 2012 at KPMG in Sydney

Position 1: The FRC is supportive of the development of the IIRC framework, but for reasons of practicality IR should take the form of 1) the existing financial statements and 2) a separate but connected statement of non-financial matters. The FRC believes that integrated reporting should aim to complement, and not substitute, financial reporting.
Do stakeholders agree with the FRC position? If not, why and what actions should the FRC undertake to refine its position?

- Table agreed that IFRS financial statements would probably stay the same, at least at this stage; and that the IR would be a separate but connected report picking up information around: governance, directors report, Chair/CEO reports, remuneration, sustainability etc. with links to the financials where applicable.
- It was considered unlikely that the conceptual framework for IFRS financial statements will change significantly – this will be the comparable 'rear-view mirror report' produced by the organisation. However, an agreed (conceptual) framework for the other report (the IR) would also be of value to ensure consistency and comparability (year on year) and to deal with risk of reporting future orientated information.
- Distinction between financial reporting and business reporting – there was consensus that the 'boundaries of financial reporting' should not be opened up by the IR debate and that IFRS is the measurement base for financial reporting; however, comments made that possibly the disclosure piece of financial reporting needs to be up for discussion re IR, as long as it was not just additional information added on top of current IFRS financial reports.
- One participant commented after the meeting about the FRC concern that the IR conceptual framework should not open up the boundaries of financial reporting. He commented that under the Corporations Act s. 299, directors are already required to report on '*likely developments in the entity's operations in future financial years*' and, under s.299. As directors of listed entities must also report on '*the business strategies and prospects for future financial years, of the entity ...*' it does not seem to matter whether the additional material is contained within the director's report or in a separate document (see Corporations Act s.1308 (7)). In practice, all IR material must necessarily widen the scope of matters on which directors will be expected to report to shareholders, and for which they will necessarily be accountable
- The biggest issue for CFOs is work load. They will not be interested if IR doesn't reduce the reporting burden. NAB experience to date in developing the IR has definitely reduced the volume of reporting.

Position 2: The FRC agrees with the challenges in the paper, and has added others. The FRC is especially concerned about the following issues which need to be addressed:
· Directors liability – directors are concerned that IR will add additional personal risk for company directors (i.e. around forward oriented information and quality of non financial data)
· Other sustainability reports – the need to clearly position the IR against other current reports – will IR replace them or subsume them.
How should these areas of concern be addressed, and by whom? What should the FRC do to drive resolution of these issues?

Directors Liability:

- AICD Corporate Governance Committee concerned with directors liability particularly disclosure of forward looking and commercially sensitive information – consideration should be given to developing additional safe-harbour protection, or use of 'carve'-out' rules as in the US.
- Comments that these concerns are a "knee jerk" reaction – and a fear that personal risk may be greater than actual risk. Director concern should be mitigated by Audit Chair oversight, robustness of information, analysis and board/ management monitoring, together with a level of assurance.
- Traditionally, directors duties are to take actions that are in the best interests of the company (including

current and future shareholders), and their responsibilities and liabilities are known already; however, with the IR, if their duties are to assess and report on matters which are material to other (as yet undefined) stakeholders – then there will need to be a framework and clear definition of what is material for the IR.

- Determining materiality is one of the most difficult issues for IR. However, it is key to understanding what needs to be reported – especially with respect to qualitative and non financial data. Directors need a detailed framework or legislation in place to assess materiality of issues, and how to address them.
- FRC confirmed that 'by providing further information' (including forward- oriented information) through periodic or other reporting, directors were not impinging on any directors duties under law.
- Mervyn King believes boards could record major decisions on what to report/ not and other major decisions in an "explanations register" which sets out the board's rationale based on available data.
- * Action: AICD and BRLF to prepare a **two page article** to explain the directors concerns, how it relates to current issues, approaches to mitigate these risks etc.

Other sustainability reports

- Voluntary sustainability report will change significantly, but not be subsumed. Further information will be required (likely on-line) for specific stakeholder information needs (which are not material to the IR value creation story) or for drill downs into more detail.
- IIRC DP (and the IR framework) has been developed to provide the material information requirements of investors – there was concern that the other company stakeholders will not be interested in the IR/ Annual Report, but will still want broader or deeper information on specific aspects of company performance and prospects. There is still a role for sustainability reporting at some level in the suite of stakeholder's reports.
- This is an area that should be developed by the IIRC, working with the pilots, to test the IR framework and also determine what other information may be required, and how it should be reported to meet the needs of other important stakeholders.

Position 3: The FRC agrees with the challenges in the paper, and has added others. The FRC is especially concerned about the following issue which need to be addressed:
· Assurance – will be required on IRs and auditors will require and audit framework
How should this area of concern be addressed, and by whom? What should the FRC do to drive resolution of these issues?

- Assurance over the IR will be required, but will be more complex than traditional financial reporting, and will require multi-disciplinary audit teams. In addition the IR information will be developed by multiple groups in the organisation, and will cross boundaries. An assurance framework is required.
- BRLF concerns include:
  - Although traditional auditors may be able to audit 'cause and effect' around performance outcomes in non financial areas; but will they have the right level of knowledge and understanding in those areas to ask the right questions and extract the right data (i.e. human rights?)
  - Will non financial auditors have the rigour in their assurance processes to obtain adequate relevant evidence, document their plans, audit work and conclusions in line with standards? Will they be subject to similar ethical and independence type rules as financial auditors?
- As a way forward, the group considered:
  - There is consistency between the principles of the main assurance standards (AA1000, ASAR3000 etc) so this would provide a good start in developing the assurance framework.
  - There is already evidence of multi-disciplinary teams providing assurance of both financial and non financial information – big 4 firms are building these teams.
  - Technology will play a more significant role in assurance over IR disclosures (especially if on-line).

Note- these notes of meeting are a best effort to summarise the comments made by the BRLF members at the two May 2012 meetings. Comments have not been attributed. If there are any additional points or material amendments, please raise them at the next BRLF meeting or contact the BRLF project lead.

- There is a need for increased training for this new career path/ these new breed of assurance providers.

- Assurance over non financial data is outside FRC mandate – however, if included in the IR, then the FRC will need to work with others to a) determine what is material b) develop consistent measurement standards/methods and c) ensure that assurance is possible over the new framework/ report.
- To what extent does IR need to be assured? If investment community uses CSR information more – then it becomes more material to decision making and so robust systems and processes will be required by organisations and independent assurance becomes more important. In South Africa, there has been that there is big demand for assurance as the directors sign off on the report.
- Massive education program also required for the investment community, superfunds etc. Investor pilots need to be clear in defining what ESG information is required to help them manage their portfolios.
- Global issue re assurance. IIRC deliberations/ international developments will be brought back to BRLF.

Position 4: IR should be developed at an international level; care should be exercised to avoid the imposition of domestic IR requirements prematurely.

Do stakeholders agree with the FRC position? If not, why and what actions should the FRC undertake to accelerate adoption in Australia? What do stakeholders think about the introduction of a 'report or explain' or 'apply or explain' framework as required now on Governance reporting in the UK and for integrated reporting in South Africa? What do stakeholders think about an 'optional' adoption of integrated reporting?

- It would be ideal to get international agreement; but expected to take time to agree on a global standard. Australia should not go alone.
- Leading organisations are likely to take IR on board as good practice; but BRLF mainly comfortable with an 'if not, why not' approach being introduced. (Maybe only for large private and public companies?)
- There should be opportunity for domestic implementation say through the ASX Corporate Governance principles. In South Africa the Exchange obligation and 'apply or explain' principle is working well.
- In developing the international approach, there should also be action taken to remove many of the various surveys and information requests that are demanded beyond the IR.
- The materiality issue must be resolved for non financial reporting purposes before the 'if not, why not' approach is adopted.

Position 5: The IIRC should develop the conceptual framework which would set out the overarching principles, then derive a definition of IR from this framework (i.e. use the building blocks from financial reporting or water accounting). The IR conceptual framework should not open up the boundaries of financial reporting.

Do stakeholders agree with the FRC position? If not, why and what actions should the FRC undertake to refine its position?

- Divergent view from the group. Much could be learned from just 'doing it' and not having a prescriptive framework up-front (i.e. developing an IR in accordance with the IIRC principles etc.); but there is merit in having a conceptual framework. Without it, there would be a 'broad church' of reporting, and potential divergence on key issues.
- For FR, there has been a need to get on with the conceptual framework, but it is still not complete. View is to develop conceptual framework to give you the foundations. But it should be principles based, and we should not repeat the mistake of over-prescription.
- Some participants had difficulty with people saying that there is no IR conceptual framework. There is and it is contained (at a high level) in the IIRC DP. It is being trialled and improved (enriched, deepened, adjusted) through the pilot process. It is consistent with the IFRS conceptual framework. The only difference is that the IFRS conceptual framework deals explicitly with two capitals (financial and

manufactured) rather than the six dealt with by the IR framework.

- With respect to opening up the boundaries of financial reporting, the group did not think this was necessary at this stage, but the FR should take into account the financial implications of externalities on value, profit and the balance sheet (i.e. cost of carbon/ other externalities). The table saw the FR and IR as touching, but not overlapping. There would be IR disclosures that are extracted or link to FR (IFRS) disclosures.
- RG230 on underlying profits is guidance on the FR. Companies have a broader opportunity to use non IFRS disclosures in the IR as long as they are explained. The IR should be more aligned to the way the business is managed and focused on the key value drivers.
- ASIC confirmed that directors are allowed now to add additional relevant information to the FR under the current conceptual framework (as long as does not replace mandatory requirements). FR driven by Corporations Act and IFRS, and the framework is well defined. RG230 is a guide to non-IFRS disclosures in this legally-driven framework. It helps ensure that directors do not 'mislead' in their disclosures.

Position 6: The FRC is of the view that enforcing businesses to issue IRs is unlikely to prove good strategy in the short to medium term, as it brings IR into conflict with existing institutional and legal arrangements and we should learn from the long road that accounting standards have followed towards a global approach.

Do stakeholders agree with the FRC position? If not, why and what actions should the FRC undertake to refine its position?

- Group agreed with FRC that IR should not be made mandatory in short to medium term. Group thought companies could actually prepare an IR under the current Corporate Reporting framework, either as the Review of Operations and Financial Condition (i.e. the G100 Guide could be re-written) or through further refinement of what is reported under principle 7 of the ASX CG principles re Risk.
- The group thought that much of the information required in an IR would be available in the investor briefing packs and management reports.
- The group considered a number of issues re mandatory reporting and conceptual framework including: a) drives boiler-plate reporting, b) would be seen as additive – CFOs in particular want some of the current reporting requirements to be withdrawn or reduced significantly (i.e. moving standing data to the website where it does not change regularly – governance framework, remuneration frameworks).
- So group thought we should try and encourage IR today through the existing framework initially.
- Reference was made to the FSC/ACSI Guide on ESG Reporting – which could potentially be used as a bridge for companies to use to enhance their 'material ESG disclosures' in current reports.
- Further comments were made that the IIRC pilot program (or other activities) should be established to develop IR requirements for each major sector – to drive a sector level of consistency.
- Concern was raised at the misuse by organisations of the exclusion allowed in the ASX CG principles around 'commercially sensitive' disclosures. There is a need for boards to be involved earlier in the reporting cycle in determining what 'material for disclosure' is and what is 'commercially sensitive'.
- *Action: Consideration should be given by the BRLF to supporting a best IR award.