

The new International Integrated Reporting Framework

A review guide for Audit Committee members





In December 2013 the International Integrated Reporting Council published the International Integrated Reporting Framework (“the <IR> framework”). This framework is voluntary in the majority of international markets, although it has since been adopted in South Africa as mandatory.

The <IR> framework is designed to enable the writing of reports that meet the needs of investors. The principles underpinning the framework are in strong alignment with the Global Reporting Initiative’s G4 reporting guidance, and it is encouraged that organisations continue to use the G4 guidance to shape the non-financial information to be included in the Integrated Report (just as financial standards guide what financial information is required to be reported).

It is important for Directors¹ to note that the framework assigns very clear and public responsibility to the Board as explained under the first section below.

The overriding question remains whether the Integrated Report explains how the organisation has in the past and plans to create and sustain value into the short, medium and longer term.

The framework includes guiding principles and content elements, all of which needs to be appropriately addressed in order for the organisation to call its report an Integrated Report. This guide has been prepared to assist Board and Audit Committee members in their review of the Integrated Report and is drafted in a question and answer manner to allow for ease of reference.

¹ While this report is addressed to the Audit Committee, this information is relevant to whichever committee has been tasked with reviewing non-financial information on behalf of the Board, which could in some instances be a Sustainability Committee, a Risk Committee, or a Health, Safety & Environment Committee.

1. Responsibility, Understanding and Involvement

Were you consulted and do you understand the basis on which the content of the Integrated Report was determined?

The Integrated Reporting Framework requires an explicit statement that must be included from the Board, consisting of:

- an acknowledgement of their responsibility to ensure the integrity of the Integrated Report
- an acknowledgement that they have applied their collective mind to the preparation and presentation of the Integrated Report
- their opinion or conclusion about whether the Integrated Report is presented in accordance with the framework

In the event that an organisation is not in the position to make the above-mentioned statement, the framework requires additional disclosure to be made regarding steps to be taken going forward to enable this statement to be made and the timeframe for doing so.

The framework clearly assigns the Integrated Report oversight responsibility to the Board. The Audit Committee needs to support and enable the Board to fulfil this function. It is therefore critical that the Audit Committee be involved in the Integrated Reporting process, and must be afforded the opportunity to provide reasonable oversight into the reporting process and output.

Key questions to be asked:

Have you been involved in the planning process?

The reporting planning process should be inclusive of all key functional areas, levels of management and members of the oversight committees. The planning process should be adequately timed to allow sufficient time for relevant input. Although in practice, the detailed planning will be delegated to the management team, it is critical that the Audit Committee is afforded sufficient time to contemplate the key themes to be articulated in the Integrated Report, prior to the report being drafted. It is no longer acceptable to present the report for information purposes to the Audit Committee at a stage that is too late to facilitate significant change.

Have the broad themes and topics discussed at Board level during the past year been covered in the report?

The process of materiality setting is defined in the framework. The litmus test for determining whether all material items are included in the Integrated Report is to determine whether the key themes discussed and debated at a Board level are featured in the report. This test speaks to the application of the collective mind of those charged with governance.

Is there any section in the report that is irrelevant, out of place or immaterial to the reader (i.e. the long term investor)?

The Audit Committee should be familiar with the concept of materiality and should question management's interpretation and application of the materiality principle. The primary users of the Integrated Report are the providers of long term financial capital. Whether or not the concerns and interests of this user group are appropriately addressed in the report should be considered. The ability of an organisation to demonstrate the materiality concept will enhance the conciseness and relevance of the report.

The Audit Committee must question any disclosure that appears isolated or irrelevant within the Integrated Report. Reporters should avoid defaulting to include disclosure relating to areas such as Corporate Social Investment, Carbon Footprint and Employee related indicators if these matters are not material or relevant. It is critical that these themes are challenged in the context of the business model of the organisation. As per the comment above, the test to be applied is the consideration of the proportion of Board time applied to these matters. If not significant, one can assume that the information should be less material to the long term investor.



Have you confirmed that the boundaries (scope of reporting) are linked to the financial boundaries, and well explained where not?

The Integrated Report boundary should be aligned to that of the financial statement boundary and scope. Deviations from the financial statement boundary should be questioned by the Audit Committee and clearly discussed in the report. It is important that the accounting rules applicable to disposals and acquisitions are consistently applied to non-financial indicators.

Do the subsections use comparable disclosure segments and definitions?

The Integrated Report must be read as one report, and providing different disclosure segments and definitions within the report may mislead the reader. It is important that common and comparable disclosure segments (for example geographical versus product based segments) and definitions are used throughout the report.

Are you comfortable that no material information has been excluded, and where it is excluded, that sufficient explanation has been provided?

The framework provides reporters with the ability to omit information where reliable information is unavailable or there are specific legal prohibitions. Where information is omitted the nature of the information as well as the reason for the omission must be disclosed. Where data is unavailable, the steps being taken to obtain the information must be disclosed, along with the expected timeframe.

The Audit Committee should ensure that any omission be appropriately understood and substantiated in order for the Committee to agree to the omission.

2. The Business Model

Does the report explain the organisation's business model and how it utilises resources in the creation of value?

Corporate reporting is, and has always been, geared towards explaining to the reader how value is created. While in the past this focused on how value was created for the organisation itself, Integrated Reporting brings balance by also including a requirement to explain how value is created for others.

The framework introduces the concept of “the stock and flow of capitals”. The capitals are stocks of value that are increased, decreased or transformed through the business model of the organisation and comprise of financial, manufactured, intellectual, human, social and relationship, and natural capital.

The Integrated Report should explain the manner in which the various capitals are transformed through the business model. The concept is not new, as the creation, reduction and transformation of financial capital has been explained in corporate reports for many years. The complexity of expanding our thinking to include all six capitals and to explain the interaction should not be underestimated.

The following questions should be asked:

- Is the business model explained in sufficient detail for an external party to understand value creation as it relates to both the organisation itself and others?
- Is sufficient information provided for the reader to understand the transformation of all six capitals? Where possible this should be done in the form of quantifiable information.
- Is it clearly set out in a level of detail that the reader can understand?
- Does the report provide commentary on the availability, quality and affordability of the significant capitals?



3. Strategic Objectives

Is what is presented a reflection of the organisation's strategic objectives?

Strategic focus should be a theme throughout the Integrated Report. The strategic objectives of the business should be linked to every aspect of the organisation's unique value creation story, and the report should explain the various strategies to ensure delivery on the objectives. By clearly explaining the strategic objectives of the organisation in the Integrated Report, the reader is able to ascertain whether or not, and to what extent the business has been successful in achieving these objectives.

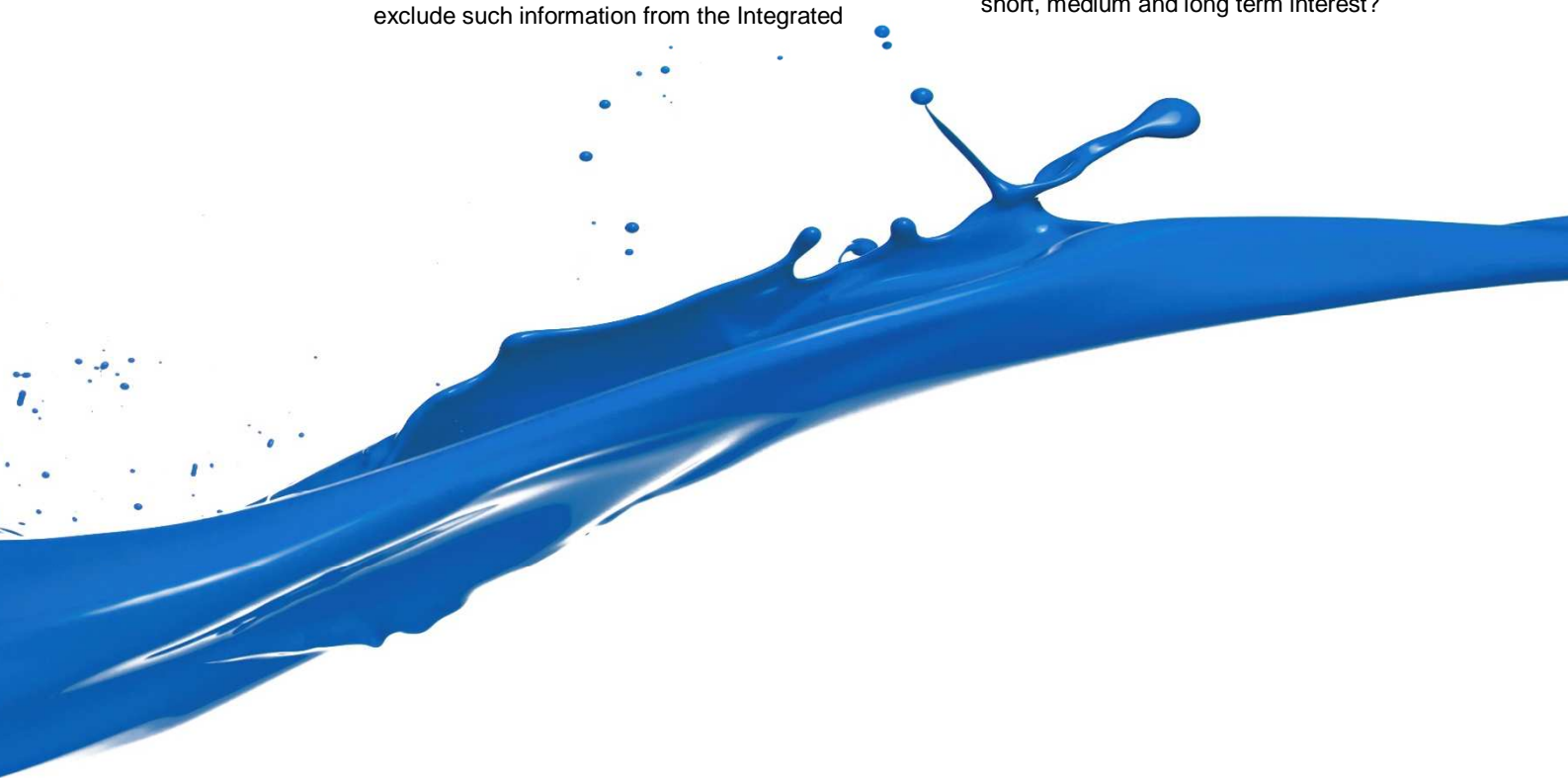
The framework requires the Integrated Report to adopt a forward looking approach and indicate how the continued availability, quality and affordability of material resources and inputs (capitals) contribute to the organisation's ability to achieve its strategic objectives in the future.

With respect to future-oriented information, uncertainty is not considered a valid reason to exclude such information from the Integrated

Report, but it does mean that key estimates and significant assumptions used by management, together with possible risks, should be included so that users can properly evaluate such information. All of these areas need to be carefully considered by the Audit Committee when reviewing the Integrated Report.

To ensure that the Integrated Report contains sufficient information pertaining to the strategic objectives, the following questions may be useful:

- Does the report reflect a similar level of detail regarding strategic objective than what is disclosed to analysts?
- Does the report highlight the significant risks, opportunities and dependencies flowing from the market positions and business model?
- Does the report reflect the Board's view of the relationship between the past and the future performance and how it balances short, medium and long term interest?



4. Key Stakeholders

Does the report provide insight into how and to what extent the organisation understands and responds to the legitimate needs and interests of key stakeholders?

'Stakeholder Relationships' is a key guiding principle in the framework. The framework requires that the Integrated Report "provides 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".

The Audit Committee must ensure that adequate processes are in place to support the stakeholder engagement disclosure. The stakeholder engagement disclosure should not become a mere list of potential concerns and issues but should support the organisation's ability to define value, identify trends, identify material matters, evaluate strategy, manage risk and implement activities. The Audit Committee should be comfortable that the level of stakeholder engagement is sufficient as well as the management processes established to identify, respond and engage with key stakeholders in order to support the Integrated Reporting process.

In order for the Audit Committee to determine whether the stakeholder engagement disclosure is adequate the following should be considered:

- Does the report define the key stakeholders?
- Does the report understand and explain how the key stakeholders perceive value?
- Does the content of the report tie back to material stakeholder concerns?
- Does the risk identified and disclosed in the report speak to the stakeholder concerns?
- Does the disclosure around stakeholder engagement provide insight into future trends identified by stakeholders?

5. Complete, Consistent, Comparable

Does the report provide consistent and comparable information similar to that applied in financial statements relating to key themes identified?

The framework introduces the principle of reliability and completeness as well as consistency and comparability. These are concepts that have been deeply embedded in financial reporting, but have not to the same extent been applied in Integrated Reporting. For the report to carry value it is critical that similar discipline as applied in financial reporting is applied in Integrated Reporting.

Key questions for Audit Committee consideration in determining the level of completeness, comparability and consistency include:

- Are indicators expressed in quantifiable measures?
Very often Integrated Reports include long descriptions of intent, but very little information to measure whether or not, and to what extent the intent has been delivered upon. Although qualitative measures inform, only quantitative measures can be tracked with more rigour. In other words, statements such as “substantial reductions”, “year on year improvement” and “significant increases” should be supported by quantifiable measures.
- Have comparatives been provided (i.e. past year and future target)?
- Have the numbers been prepared on a comparable and consistent basis?



6. Contextual vs. Concise

Even though one of the framework's guiding principles is conciseness, does the report provide sufficient context to allow the reader to understand the organisation's strategy, governance, performance and prospects?

The challenge of achieving conciseness in Integrated Reports is well recognised. Research conducted by Deloitte in South Africa of the Integrated Reports of companies listed on the Johannesburg Stock Exchange indicates that the average length of reports is between 80 to 120 pages (excluding the annual financial statements).

Achieving conciseness in describing complex information is not easily achieved. It requires having clarity and alignment on what it is about. It further requires being ruthless in excluding that which does not clearly aid understanding the fundamentals of the organisation, what it is trying to achieve and what its prospects are. The number of pages required to write a 'concise' report varies from organisation to organisation, and depends on the complexity of the business model and the data presented. The framework allows for cross-referencing to websites and other reports (e.g. the sustainability report, governance report, annual financial statements, etc.). This allows an organisation to exclude detail from the actual Integrated Report, while making the information available to the reader. The key is to tell a comprehensive story, which includes all (and only) material information in the report.

In our opinion, companies are making good progress towards concise Integrated Reports and the current trend needs to be maintained. Ultimately, conciseness is pivotal and non-negotiable in enabling and empowering an organisation to tell its story in a way that stakeholders will clearly and easily understand.

Further questions:

- Does the report express concepts clearly, in plain language and avoid generic disclosure?
- Does the report follow a logical structure?
- Is there sufficient disclosure in the Integrated Report for the report to stand on its own?
- Are links provided in areas where more information is required?



7. The Eight Content Elements

Does the report include the eight content elements as required by the framework?

Organisational overview and external environment

The Integrated Report should answer the question – What does the organisation do and what are the circumstances under which it operates?

Governance

There are a number of matters to consider with respect to the governance information disclosed in the Integrated Report.

In the first instance the report should provide a clear description of the governance framework employed by the organisation to ensure delivery on the strategic objectives and the creation of value. Insight should be provided on the leadership structure, diversity, decision-making processes, culture, ethics and values, innovation, and remuneration incentives.

Organisations using the Global Reporting Initiative's G4 guidelines to report their sustainability information have a broad set of specific required governance disclosures, including for example:

- Identify any committees responsible for decision-making on economic, environmental and social impacts.

And listed companies will already be disclosing a number of governance related items, as required by the NZX listing rules. For example:

- A statement of any corporate governance policies, practices and processes, adopted or followed; and
- A quantitative breakdown of the gender composition of the issuer's board of directors and its officers.

Business model

The organisational business model is explained in detail in section 2.

The framework recommends that the Integrated Report includes:

- an explicit identification of key elements of the business model;
- a simple diagram that highlight the key elements;
- a logical explanation of the particular circumstances of the organisation; and
- identification of the critical stakeholders and other dependencies (like raw material) as well as critical factors impacting the external environment.

Risk and Opportunities

For an organisation to demonstrate their ability to create and sustain value over time, the key risks and opportunities in delivering on the strategic objectives need to be determined. The framework requires that the key risks and opportunities be disclosed, as well as the measures in place to manage the risks and opportunities.

The Audit Committee, as well as the Risk Committee should ensure that the disclosure in the Integrated Report is an accurate reflection of the organisation's key risks and opportunities, and should consider both the internal and external sources.

The Audit Committee may view the identification and disclosure of the risks and opportunities and the identification of material matters as congruent.

Strategy and resource allocation

The report should clearly explain where the organisation wants to go and how it intends to get there. The framework requires companies to provide detail on its strategic objectives, and the strategies required to achieve such objectives. To some extent, this becomes the underlying theme of the Integrated Report. The framework requires a clear explanation of the relationship between the strategic objectives and the business model, the impact of the external environment as well as the key risks and opportunities, and the effect of the latter on the organisation's strategy and on the various capitals.

Performance

The report should explain the extent to which the organisation has achieved its strategic objectives and how achieving these objectives impacts on the capitals.

This includes quantitative indicators with respect to risks, targets and opportunities; the organisations' material impacts on the capitals as well as linkages between past and current performance, and between current performance and future outlook.

Audit Committee's should consider the balance of performance and the completeness of the performance areas reported on. Comfort should be sought from assurance functions as to the reliability of reported performance. The application of combined assurance model over key financial and non-financial performance measures should be considered.

Outlook

In order to cover this content element, the report should explain the key challenges and uncertainties the organisation is likely to encounter in pursuing its strategy, and the potential implications for its business model and future performance.

The framework requires a transparent analysis of the Board and senior management's expectations about the external environment the organisation is likely to face in the short, medium and long term. This analysis should also include how it will affect the organisation and how the organisation is currently equipped to respond to critical challenges.

The disclosure should provide the reader with an understanding of the main assumptions and possible risks and opportunities, and should provide lead indicators, target KPI's, forecasts and projections where practicable. It is important to see this content element in the context of the guiding principles, specifically the principles of materiality, reliability and consistency. In other words, the rules around disclosure relating to omissions based on unavailability of reliable data, legal prohibitions and competitive harm should also be applied when determining the extent of disclosure of information relating to the future outlook.

Basis of preparation and presentation

With regards to basis of preparation, the Integrated Report should cover how it was decided what matters to include and also how such matters were quantified and evaluated.

The Integrated Report should include a description of the process used to identify material matters and should explain how senior management and the Board applied their mind to the prioritisation of these material matters.

The Integrated Report should also explain the reporting boundary and how it has been determined.

Lastly, the report should include a summary of the significant frameworks and methods used to quantify and evaluate material matters. This most commonly includes a reference to at least the governance framework, the accounting framework and the sustainability framework applied in the preparation of the report.

Conclusion

It is important that the Audit Committee (or another Committee delegated with this task) assist the Board in approving the disclosure of non-financial matters in the Integrated Report by ensuring that the information is reliable and that no conflicts or differences arise when compared with the financial results. Before the Audit Committee recommends the Integrated Report to the Board for final approval, the Committee should ensure that it is comfortable that all material information is included in the report and that such information has been verified and assured (the combined assurance model can be utilised in this regard).

The list of questions provided in this review guide should assist the Audit Committee (and the Board) to ensure that they pay attention to all relevant matters in both the Integrated Reporting process and the Integrated Report itself.

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