PETER BURGESS COMMENTS ON THE IIRC CONSULTATION DRAFT PREPARED BY THE INTERNATIONAL INTEGRATED REPORTING COUNCIL (IIRC) … JUNE 2013

This paper has some summary material extracted from the IIRC Consultation Draft that were deemed of interest for comment, together with the Peter Burgess comment in italics and indented.

At the end of the paper, there are some 'big points' that reflect an overall assessment of the state of development of this consultation draft and how useful it is.

This is a work in progress, and it is expected that it will be substantially revised in the early future.

Integrated Reporting (IR)

Overview

Fundamental concepts

- The Capitals:
  - Financial;
  - Manufactured;
  - Human;
  - Social and relational; and,
  - Natural
- The Business Model of the organization
- The Creation of Value over Time

The report assesses the ability of the organization to create value in these time frames:

- Short
- Medium
- Long Term

Guiding Principles

The guiding principles of

- Strategic Focus and Future Orientation
- Connectivity of Information
- Stakeholder Responsiveness
- Materiality and Conciseness
- Reliability and Completeness
- Consistency and Comparability

Guiding Principles

The idea of 'principle based' requirements:

- Strategic focus and future orientation
- Connectivity of information
- Stakeholder responsiveness
- Materiality and conciseness
- Reliability and completeness
- Consistency and comparability

Content Element

An IR should answer the following questions:

> *This is in contrast with TVM which does not want an 'answer' to the questions in a narrative form but wants to know what impact, expressed in a unified quantified form, there has been, and what resources were deployed to get these results.*

- Organizational overview and external environment

> *Nothing yet*

- Governance

> *In the IRF governance refers to the way the organization governs itself. In TVM how the organization is governed is of no concern, what matters is the resultant* ***Valuadd*** *and the* ***Resources deployed*** *to get the Valuadd*

- Opportunities and Risks

> *In the Value Accounting System, there is detailed information about the performance of the organization in creating value, i.e. producing Valuadd. In the IR there is only the Summary Report of Valuadd*

- Strategy and Resource Allocation

> *What the organization 'says' it wants to do is of little concern in TVM reporting. TVM is concerned with what the organization has done, and the 'State' of the organization with respect to itself and to all entities with which it has had and does have interactions.*

- Business Model

- Performance
- Future outlook

There should also be required disclosures

How does the organization determine materiality

What is the reporting boundary and how has it been determined

The governance body with oversight responsibilities

The nature and trade-off that influence value creation over time

What has been considered immaterial

Preparation and presentation

Strategic focus and future orientation

Integrated Thinking (page 9)

Integrated thinking is defined as the active consideration of the relationship by an organization between its operations and the capitals that the organization uses and affects (1-16) It is further defined later (1-17)

> *There is silo thinking in the IR principles being articulated. Everything is from the perspective of the organization which is often different from those of other entities. This may be complex, but it must be handled. People may be stakeholders in the organizations as investors, as management, as production staff, as people in the supply chain, as consumers, as family of the organization's first circle stakeholders, as members of a place (community) where the organization operates, and as people concerned about the state of the planet*

> *A good system of reporting informs the reader of the performance of the entity, the state of the entity, but need not, nor should not, be informing outsiders about any internal processes and activities that go into producing the results. An organization should, for example, report on the impact of its waste, but need not report on the technical aspect of the processes being used to manage waste. The reporting is to enable measurement of impact and performance, not to serve as a way to exchange technical information.*

The IR Framework does not prescribe specific indicators or measurement methods to be used in an IR. (1-19)

> *Without this the requirement for comparability is critically compromised, together with almost everything else of value in the IR concept*

The IR Framework describes how the IR differs from other forms of communication (1-20)

Restates the elements already noted on page 6 … good ideas but where is the methodology to do these things

2B Capitals

The stock and flow of capitals is described but the emphasis is on the flows more than in the stock. (2-11 and 2-12).

The image on page 10 is interesting. It is very similar to a series of images that have been created in connection with the development of TVM. The difference is that in the TVM version the left hand side starts with the 'State' at the beginning of the period (BOP) and the right hand side ends with the 'State' at the end of the period (EOP). What goes on in the middle are all the economic activities that result in either good outcomes, or bad outcomes, or a mixture of both. In the TVM version, the 'State' of both the reporting entity and everything else are considered together as one. Various perspectives are possible depending on the reporting entity.
The image on page 11 goes some way towards the TVM model. There is something labeled organization and something labeled society that seems similar to the 'State' referred to in the note above. In TVM there is reference to resources rather than capital, though the idea is similar. What they are called is unimportant, but what they 'are' is very important. In TVM there is an assignment of 'value' to resources so that when they are consumed there is a quantification of resource loss of value destruction. Similarly there is assignment of value to outcomes, as well as all the elements that go into the computation of 'State'. This image gets into a lot of detail about the elements that go into the make-up of the business model that is internal to the organization. In TVM this detail is of little concern. The critical matter is what inputs go in and what outcomes come out.

Ownership of the capitals

The fact that an organization may not be the owner of a capital that is impacted by its operations is referenced (2.23) see further below under Value Creation

Quantification of qualitative information

The IR does not require quantification, but does ask for narrative of qualitative perspectives.

Complexity, interdependencies and trade-offs

The IR does not require much in respect of these matters

2C The Business Model

See Figure 3, page 11 referred to above

Inputs

(2-28 … 2-29)

Business Activities

(2-30 … 2-32)

Outputs

(2.34)

Outcomes

(2.34 … 2.36)

2D Value Creation

(2.37)

Value for Providers of Financial Capital

(2.38 … 2.40)

The Meaning of Value

Present value of future cash flows … plus other factors. (2.41)

Not the purpose of the IR to report about value (2.42)

> *This is a very important section, but the IR avoids 'upsetting the apple cart' by making it clear that the IR will not engage in 'valuing' the capitals and the changes in capitals. This is absolutely the opposite position to that of TVM which has the position that these changes in capitals (resources) are absolutely critical to having meaningful metrics and reporting that will get attention.*

Value Drivers

Financial drivers

Customer oriented drivers

Integrity drivers and the like

3 - GUIDING PRINCIPLES

3A Strategic Focus and Future Orientation

> *The TVR approach to future projections is that they do not belong in an IR. There is nothing wrong with communicating these matters as part of the organizations marketing, PR and financial propaganda, but they have no part in a report that aims to be about performance in the past and the resultant state in the present.*

3B Connectivity of information

Reference is made to the Content Elements (3.10).

The organization's external environment

- Organizational governance
- Opportunities
- Risks
- Strategy
- Resource allocation
- Business model
- Performance
- Future outlook

> *What are KPIs … they are Key Performance Indicators*

> *The matters referred to in the IR principles about connectivity of information are important, but they are not something that should be 'talked about' in the report, but should be embedded into the methodologies used to prepare the analysis and do the reporting. This is the focus of TVM. The use of 'Change in State' to measure progress or valuadd or value destruction is a very powerful way of getting at impact without having to articulate all the complexities of the connectivity which does nothing but confuse.*

3C Stakeholder responsiveness

An integrated report enhances transparency and accountability (3.16)

> *It easy to agree with this idea, but in practical terms it is 'hogwash'. The problem of transparency and accountability have to be dealt with, but the IR being described by IIRC is not the vehicle. These matters are part of the TVM framework, but are not part of the organization reporting module*

There are some interesting issues raised in 3.20 and 3.21.

An interesting part of the analysis and reporting has to do with value chains. Value chains are not only the supply chains, but also are the manner in which value changes depending on time, or place, or organization, or perspective. This makes the quantification process complex, but in the end there are ways to keep quantification relatively simple.

3D Materiality and conciseness

An IR should provide concise information that is material to assessing the organization's ability to create value in the short, medium and long term

If the reporting process is based on quantified data, the issue of materiality is handled automatically. If the data are presented in quantified forms that are widely accepted, then the reporting can be concise. Anything that relies in narrative is going to be long-winded and inconclusive.

3E Reliability and completeness (page 21)

An IR should include all material matters, both positive and negative in a balance way and without material error

Reliability

Balance

Freedom from material error

Completeness

Cost/benefit

Competitive advantage

Future oriented information

3F Consistency and comparability

The information in an IR should be presented on a basis that is consistent over time and in a way that enables comparison with other organizations to the extent that is material to the organization's own value creation story

Consistency

Comparability

Quantified information

- Benchmark data
- Commonly accepted ratios

- Some quantitative indicators

    The quantification of value so that it may be used in an IR framework is essential. There has been a vast amount of work done to establish benchmarks, to start using some commonly accepted ratios and other quantitative indicators, but so far these efforts have remained unconnected, TVM is working to provide a framework for quantifying value that embraces these initiatives and results in a uniform system of standard values that can be generally accepted.

4 CONTENT ELEMENTS

An IR should stand alone as a concise communication, linked to other reports and communications for those stakeholders who want additional information. (4.4)

4A Organizational overview and external environment

An IR should answer the question : What does the organization do and what are the circumstances under which it operates. (4.6)

4B Governance

An IR should answer the question: How does the organization's governance structure support its ability to create value in the short, medium and long term?

4C Opportunities and Risks

An IR should answer the question: What are the specific opportunities and risks that affect the organization's ability to create value over the short, medium and long term, and how is the organization dealing with them?

4D Strategy and Resource Allocation

An IR should answer the question: Where does the organization want to go and how does it intend to get there?

4E Business Model

An IR should answer the question: What is the organization's business model and to what extent is it resilient?

Organization with multiple business models

The problem of large complex organizations needs to be addressed. Experience shows that large organizations comprise a wide range of different business models, but also include key staff with widely differing concepts of what is ethically acceptable. The only common thread is that they all are controlled internally by the priority of profit. The

TVM approach is to have every location of an organization accountable and reporting in the location … that is the place and the community … as well as internally for corporate aggregation.

4F Performance

An IR should answer the question:

4G Future Outlook

An IR should answer the question: What challenges and uncertainties is the organization likely to encounter in pursuing its strategy and what are the potential implications for its business model and future performance?

5 PREPARATION AND PRESENTATION

5A Frequency of Reporting

5B The materiality determination process

5C Disclosure of material matters

5D Involvement of those charge with governance

5E Credibility

5F Time frames for short, medium and long term

5G Reporting boundary

Figure 7 shows the reporting boundary for a parent company and subsidiaries. It is based on the idea that the financial reporting boundaries that should be used because 'it provides information to the providers of financial capital'. This is the wrong end basis for boundary determination. The boundary should be determined by the nature of the *economic activities over which the organization has control, and the manner in which these activities impact people, place, and planet.*

5H Aggregation and disaggregation

5I Use of technology

Web-based media

XBRL

Big Points

How to look at the structure of the economy and society

The central challenge of a system of metrics and reporting is to respect the nature and structure of all economic activity and the impact there is on social and economic life of people and place, as well as the impacts on the planet?

The purpose of economic activity is to make a positive contribution to the improvement in quality of life of people and place, and not to damage the planet in the process.

The organization is part of the structure, but it is 'in' a bigger structure, rather than being a big important structure with everything else 'outside'.

Similarly 'government' is just another part of the structure, and 'in' a bigger structure, rather than being 'on top' of everything.

Reporting

The purpose of reporting is to help with accountability. An efficient reporting process is big on information but small in size and low in cost.

Comparability is important. This argues for a system of quantification that can be broadly accepted. It is very difficult to compare text answers to questions.

Reporting should be mainly about what has happened in the past, and what is now the present state.

Projections about the future should be separate from the reporting about the past, the current period and the present state.

The impact of past actions on the future should be brought into account. This is not the same as making future projections about future actions.

Is this a public Business Plan … or what?

As I read the detail of this, it reads more like how to make a detailed business plan than how to prepared a report on performance and the state of the entity. If I was a responsible manager in charge of this exercise I would have to be impossibly careful about the problem of divulging competitive information. Frankly, the methodology being developed is going to be costly and not very valuable.