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Comment on Assurance on Integrated Reporting papers

The Institute of Internal Auditors South Africa appreciates the opportunity to provide comment on the proposed Assurance in Integrated Reporting (IR) Framework documents.

Integrated Reporting (IR) as a new way of thinking and reporting on corporate performance and value creation is in its very early stages. As a result, there is no mandate for adoption, no fully defined way that IR will be implemented, and therefore no one way to provide assurance on IR.

Underlying the IR Framework is the concept of integrated thinking, which addresses not only how organisations approach external reporting, but also how they look at their business activities. Integrated thinking challenges an organisation to draw connections among disparate reporting elements in order to communicate a more accurate and complete picture of value creation. In action, integrated reporting has the potential to break down silos and lead to greater innovation.¹ This is congruent with The IIA's Three Lines of Defence model², which serves to break down silos for risk management and control processes to integrate and coordinate activities among:

1. First line of defence operational managers that own and manage risks.
2. Second line of defence functions that oversee risks, such as risk management and compliance functions.
3. Internal audit, the third line of defence that provides independent assurance on the effectiveness of governance, risk management, and controls.

¹ Integrated Reporting and the Emerging Role of Internal Audit, The Institute of Internal Auditors (IIA), 2013

² The IIA's Position Paper, The Three Lines of Defense in Effective Risk Management and Control, 2013

In order for integrated reporting to be seen as a reliable instrument for assessing the organisation's ability to create value in the short-, medium-, and long-term, organisations will need to provide assurance regarding the information reported therein. Internal audit is the natural choice to provide key aspects of assurance. Internal audit can provide the third line of defence in effective risk management and controls for value creation and integrated reporting inasmuch as it provides the third line of defence for an organisation's other strategic and reporting objectives, respectively.

The value in IR depends on the reliance placed on an integrated report by third parties. Meaning, how much does the data of an integrated report (both qualitative and quantitative) inform and influence third parties' judgments, decisions and actions over and above what traditional financial reporting has done as it relates to an organisation. To have such an influence, the integrated report must be deemed as credible and reliable. Credibility and reliability should result in trust, which is where assurance comes into play.

There should be an appropriate mix of external assurance regardless of the form of external assurance provided (reasonable, limited, hybrid and/or agree-upon procedures) combined with internal assurance providers (e.g., second and third line of defence functions) in any evolving assurance model.

Consequently, it has to be the market, as influenced by those third parties who choose to rely on IR, that will determine an appropriate assurance model. That assurance model will need to consider what the more material aspects of IR are and how, in the most cost-effective manner, an appropriate level of assurance could be provided. And, how a third party looking for assurance will quickly discern what aspects of IR did or did not receive assurance, and at what level.

Regardless of what assurance model begins to evolve, internal audit is well-suited to provide support. Internal audit is uniquely situated within an organisation to provide insight on and support the implementation of integrated reporting. Internal audit:

1. Is familiar with process implementation in the organisation.
2. Can affect consistency of communication of metrics across business units.
3. Provides internal assurance to increase the credibility of metrics in the integrated report.
4. Offers insight on potential risks to the organisation.
5. Has a "seat at the table" from which it can influence the adoption of IR to improve and strengthen communications with internal and external stakeholders.³
6. Is adept at working with external assurance providers.

We strongly believe that internal audit will play at least three critical and distinct roles in supporting the reliability and credibility of IR³. Those three roles are:

1. For a company implementing IR, internal audit should be involved in the project team to lend advice to the implementation activity and be in a position to provide assurance to those charged with governance that the implementation is being done effectively. However, internal audit should not own, or be responsible for the implementation of, IR processes, policies, or procedures.
2. For a company implementing IR, internal audit should provide assurance on the accuracy and reliability of the data being reported, both internally and, as appropriate, externally.

³ Integrated Reporting and the Emerging Role of Internal Audit, The Institute of Internal Auditors (IIA) ©2013

3. And, for a company that has some aspects of IR receiving external assurance, internal audit should partner with external assurance providers to ensure that the assurance engagement is conducted in the most cost-effective, efficient, and reliable manner.

Responses to the questions are attached to this letter as Appendix-A.

Yours sincerely



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Q1. What priority should be placed on assurance in the context of driving credibility and trust in IR?

The question seems to be worded backward. The question should be, “what priority should be placed on credibility and trust in the context of IR assurance”?

The content of an integrated report will presumably be worthless if it is not credible, and credibility can only be achieved through the provision of assurance. A third party will only trust (i.e., place reliance on) credible content. Therefore, the highest priority should be placed on credibility and trust that provides the best overall value in relation to the overall cost.

Q2. What are the key features of assurance that will best suit the needs of users of integrated reports in years to come?

Assurance is not an outcome or a report, but a process. Key features of assurance include:

- Assurance must be based on sufficient, reliable, relevant, and useful information.
- Assurance must be performed independently of the underlying processes, by competent and objective individuals, and based on a set of widely recognized standards (underpinned by a set of concepts such as what is articulated in the IAASB’s International Framework for Assurance Engagements).
- Assurance may be evidenced by a report or written conclusion (per paragraph 3.5 of the Introduction paper), but it is the underlying process that will actually create the value to best suit the needs of users of integrated reports over time. (e.g., a process that includes how the assurance is obtained, the type of assurance and level of assurance)

Q3. Is the availability of suitably skilled and experienced assurance practitioners a problem in your jurisdiction, and if so what needs to be done, and by whom, to remedy the situation?

There will be a skills shortage in the immediately foreseeable future, resulting in potentially elevated costs for appropriately competent assurance. This may result in either limited assurance work being performed in the short-term, or assurance being conducted by individuals with potentially insufficient competence to perform the work. Internal assurance providers (such as internal audit) must be seriously considered as part of a holistic assurance model that is not only competent, but cost-effective. External and internal assurance providers, professional trainers, collegiate accounting programs, regulators, accounting licensing bodies and others will need to determine whether tomorrow’s demand for integrated reporting assurance providers will support today’s investments in skills development needed to effectively perform integrated reporting assurance across all six capitals.

Q4. What needs to be done, and by whom, to ensure the quality of assurance on IR is maintained at a high level, including practitioners’ adherence to suitable educational, ethical (including independence), quality control and performance standards?

The only effective way to ensure quality is to enforce, as best as possible and practical, adherence to a set of globally recognized, supported and adopted integrated reporting assurance standards. Any developed and globally promulgated standards must then be supported by implementation guidance, training, and competency testing. As well, over time, it would be logical that a either a portion of existing demonstrations of proficiency (certifications) or new demonstrations of proficiency (or both) would develop and or emerge.

Q5. Is the robustness of internal systems a problem, and if so what needs to be done, and by whom, to remedy the situation?

Financial reporting systems have evolved over time to such a degree that there is a high level of reasonable assurance over the resultant financial reports; however, the robustness of systematic and manual internal systems today are not sufficient to support a full implementation of the IR Framework. Integrated reporting reliability and credibility will need to be based on applying the same or similar internal control disciplines that are exercised over financial reporting today, i.e., a robust set of internal controls, built upon adherence to and implementation of an internal controls framework (such as the COSO Internal Control – Integrated Framework). Progressive companies have adopted the COSO Framework (or other such suitable framework) to apply across all their enterprise, not just for financial reporting purposes.

Q6. Is assurance likely to be a cost effective mechanism to ensure credibility and trust over (a) the short/medium term; (b) the long term?

Assurance models, especially those relying on external provisions of assurance, are inherently costly due to the nature, extent and timing of the effort required to obtain some level of reasonable assurance. Costs include compensation for external assurance provider's time, with a suitable risk premium, plus the cost of the internal resources required to support the external assurance work (both additional resources and the opportunity cost of existing resources). It is therefore tantamount that the assurance model be one of integrated or combined assurance, whereby both external and internal assurance providers can be effectively deployed to achieve a level of assurance that best balances cost and utility with marketplace demands.

Q7. If so, what needs to be done, and by whom, to maximize the net benefits of assurance?

Pilot companies need to explore various assurance models to see what seems to work best from a cost/benefit and reliance standpoint; the investment community must be engaged extensively to determine what is needed to enhance reliability; and, independent, objective valuation studies will need to be undertaken, over time, to determine whether there is tangible benefit being derived for the companies who choose to take a leadership role in the evolution of integrated reporting.

Q8. Should assurance standard setters develop either or both (a) a new assurance standard; (b) guidance, to ensure consistency of approach to such issues?

Existing assurance standards and guidance needs to be evaluated, an extensive list of which was provided in the "An Exploration of Issues" paper, by a non-partisan group, to determine the applicability and suitability to support assurance in today's environment. As integrated reporting evolves, so will developed and promulgated standards and guidance to support the effort required for providing assurance. The global accounting, investment community, internal audit, board/audit committee, and financial management communities will need to come together and collaborate on the evolution of not only assurance standards and guidance to support the future assurance expectations around integrated reporting, but also to collaborate in a non-vested interest way toward the evolution of suitable, cost-effective models of acceptable and reasonable assurance.

Q9. Should any such standard/guidance be specific to IR, or should it cover topics that are also relevant to other forms of reporting and assurance, e.g., should a standard/guidance on assuring narrative information, either in an integrated report or elsewhere, be developed?

It is premature to predict what the correct form any standards/guidance should take, and the elements of the considerations we have suggested in the previous answers (specifically to Q7 and Q8) will need to be explored thoroughly. However, it is likely that there will need to be generalized principle-based standards that might transcend all types of reporting and assurance, as well as detailed standards covering specific topics, and/or IR Framework capitals and content elements.

The IIA's *International Standards for the Professional Practice of Internal Auditing (Standards)* include numerous standards focusing on governance and risk management. Conformance with these standards will allow internal audit to help organisations prepare for and implement IR. As part of The IIA's continuing monitoring and development of its International Professional Practices Framework (IPPF), including the *Standards*, The IIA will determine the need for developing additional guidance to address assurance on IR. Such guidance would include detailed processes and procedures, such as tools and techniques, programs, and step-by-step approaches, including examples of deliverables.

Q10. What are the (a) key challenges and (b) proposed approaches that assurance standard setters should consider with respect to:

- Materiality?
- The reporting boundary?
- Connectivity?
- Completeness?
- Narrative reporting and future-oriented information?

These parameters are the key challenges facing what will constitute cost-effective, reasonable assurance over integrated reporting, especially for non-financial reporting as well as the interplay between non-financial and financial reporting. Whole papers and dissertations could be developed about each of these five parameters that would, more effectively, be best addressed through continued dialogue and debate, especially at this early stage.

Q11. What other technical issues, if any, specific to IR should be addressed by assurance standards setters?

One critical technical issue will be to begin to identify acceptable models of combined (or integrated) assurance. Such models would include roles, responsibilities, and reporting protocols for both external and internal parties to an organisation.

Another technical issue will be the differences that emerge across geographic localities and industry sectors and the potential need for standards and/or guidance that address these differences.

Q12. What are the (a) key challenges and (b) proposed approaches that assurance standard setters should consider with respect to:

- Reasonable assurance?
- Limited assurance?
- Hybrid engagements?
- Agreed-upon procedures engagements?
- Other approaches?

A combined approach will have to emerge, in our view. Complete reasonable assurance across an entire integrated report could be cost-prohibitive, whereas complete limited assurance would not provide sufficient assurance on what might be deemed material. Consequently, some form of hybrid engagement, or combined assurance, is the only model that can be successful over time. The market place (e.g., IR users) will determine where reasonable assurance is needed versus limited assurance being acceptable. Agreed-upon procedures likely will not have a viable place in a long-term assurance model as the procedures for such work are developed by the party requesting the work. Such an agreed-upon procedures model does not seem to have a successful place, over time, in providing sufficient value to those who would place reliance on the content of an integrated report.

Q13. What are the (a) key challenges and (b) proposed approaches that should be considered, and by whom, to ensure assurance on IR pays due regard to other assurance processes?

As mentioned previously, the only viable long-term model we see is one that is an integrated or combined assurance model. This will require the non-competitive collaboration of both external and internal assurance providers, most notably among and between external audit and internal audit practitioners. To achieve such a combined assurance model will require combined or integrated standards and guidance, emanating from collaboration between and among all interested parties (external and internal assurance providers, the investment community, corporate governance experts, regulators, etc.).