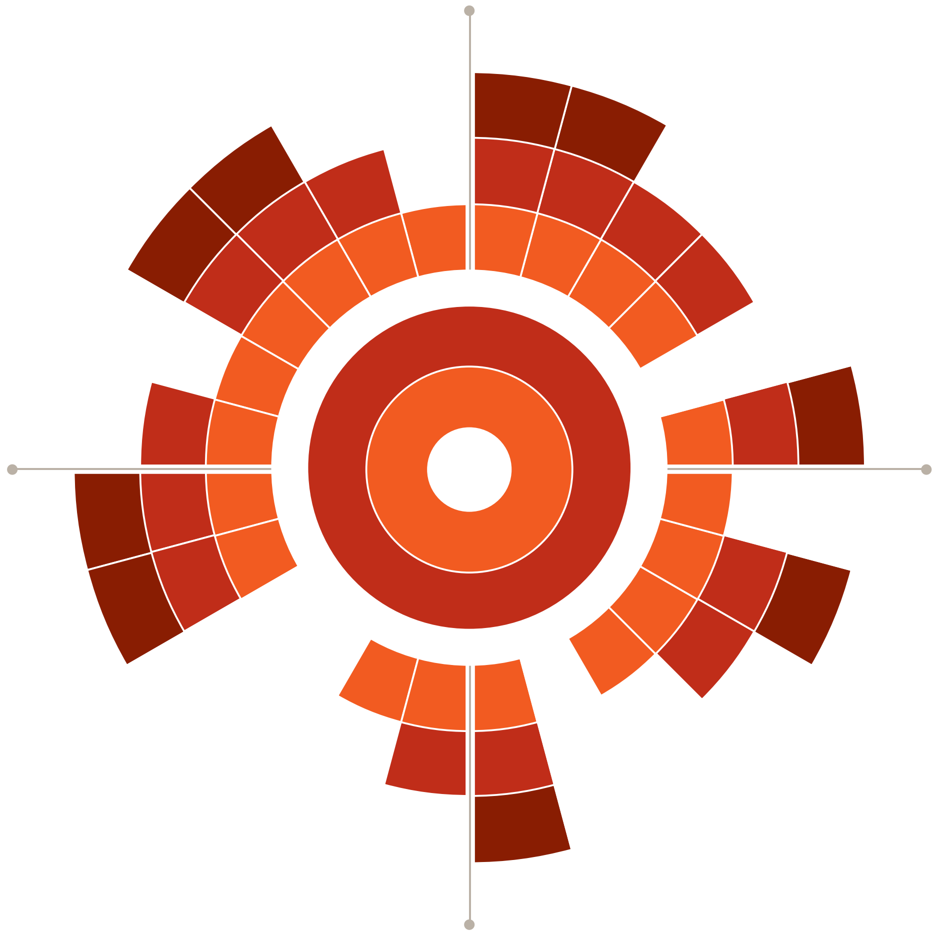
Inspiring trust through insight



The way that organisations report is evolving to reflect the new demands of a changing world and a broader set of drivers of value creation. I asked two thought leaders, Diana Hillier and Ian Hitchen, working with subject matter experts, to think about how we could support and accelerate this evolution. I wanted them to be prepared to think of innovative ways that we could build trust in an organisation's reporting as it evolves.

I'm excited by the ideas and encourage others to join the debate.

Richard Sexton
Vice Chairman, Global Assurance

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Executive summary *Inspiring trust through insight*

The focus of business and reporting is changing

Successful business leaders recognise the need to focus on sustained value creation. Now more than ever, this requires a broader view of growth than just increased output and short-term financial returns, as significant mega trends are putting to the test the resilience, sustainability and impact of organisations' strategies and business models. Sound business decisions increasingly need to reflect accountability to a wider set of stakeholders, and require broader and more integrated consideration of the outcomes and impacts of an organisation's activities. Corporate reporting – both internal and external – is evolving to reflect these shifts.

Today's assurance model doesn't easily support change

The audit has played, and continues to play, a critical role in building trust in financial reporting. But today's broader assurance model is not always an easy fit with corporate reporting, which is transitioning to a model that is broader, more forward-looking and more integrated. This stems largely from the fact that, at its core, the concepts underlying the assurance model have their roots in the audit of financial statements, which is a mature, historical and financially-based reporting model. We and other interested parties need to be bold enough to think differently about how else we could build trust in an organisation's reporting as it innovates and experiments with more progressive reporting.

We believe there is another way to build trust

To help address this need, we propose an approach focused on providing insight into various dimensions of an organisation's reporting, rather than a conclusion on its compliance against set criteria. This would let people look behind what's reported to understand where the organisation is on its reporting journey, and make their own decisions on the level of trust they place in the information and how they use it. We envisage a visual representation of the maturity of the information, supplemented with a narrative commentary, which could give preparers and users an immediate impression enhanced by deeper insight, all based on informed professional judgement.

The aim is to accelerate change

Organisations' internal and external reporting is already beginning to evolve to reflect the new demands of a changing world and a broader set of drivers of value creation. The assurance profession should support and accelerate this journey – but we need to be prepared to think outside the box about how trust can be built in new and innovative ways. Moving the thinking from concept to reality will bring its own challenges. However, we believe it has tremendous potential to create enhanced value, both for users and preparers of corporate reporting. We think that's an outcome worth pursuing.

We welcome your thoughts

We are keen to work with organisations and other stakeholders to develop the thinking further. We look forward to seeing whether others share our view.

In an effort to build trust, raise capital and drive sustainable growth, organisations are increasingly having to think in more holistic and integrated ways.

The drivers of more integrated thinking

Organisations of all sizes in all industries are facing an unprecedented array of challenges arising from global macro trends, including – but not limited to – sustained economic uncertainty; unrelenting public scrutiny; changing stakeholder values; and increasingly interdependent stakeholder relationships. At the same time as introducing new risks to business, today's 'global megatrends' are also presenting organisations with major opportunities to grow into new markets with innovative products and services, and to attract employees, business partners and investors to support them in this growth.

This is transforming the environment for business. In an effort to build trust, raise capital and drive sustainable growth, organisations are increasingly having to think in a more holistic and integrated way about the direct and indirect impacts of their strategies, business models, values and behaviours along their entire value chain.

Expanding from financial to holistic reporting

At the heart of this rethink is a recognition by a growing number of organisations that managing value creation and – more fundamentally – retaining their licence to operate now involves much more than managing their financial capital on behalf of stakeholders. They can see that a broader set of integrated information is needed to satisfy an increasing number of stakeholders – all with potentially different perspectives of value.

To gain this wider perspective, many organisations may need to undertake structural change to break down silos and 'rewire' their organisations to embed more integrated thinking. Making these changes isn't easy – and often involves venturing into uncharted territory. Why? Because a focus on past financial performance has dominated businesses and markets since their inception, and moving beyond historical financial measures to areas that have no common definition of value is a major break with the past.

To achieve such change effectively, organisations need to enhance the breadth and quality of their internal and external business information.

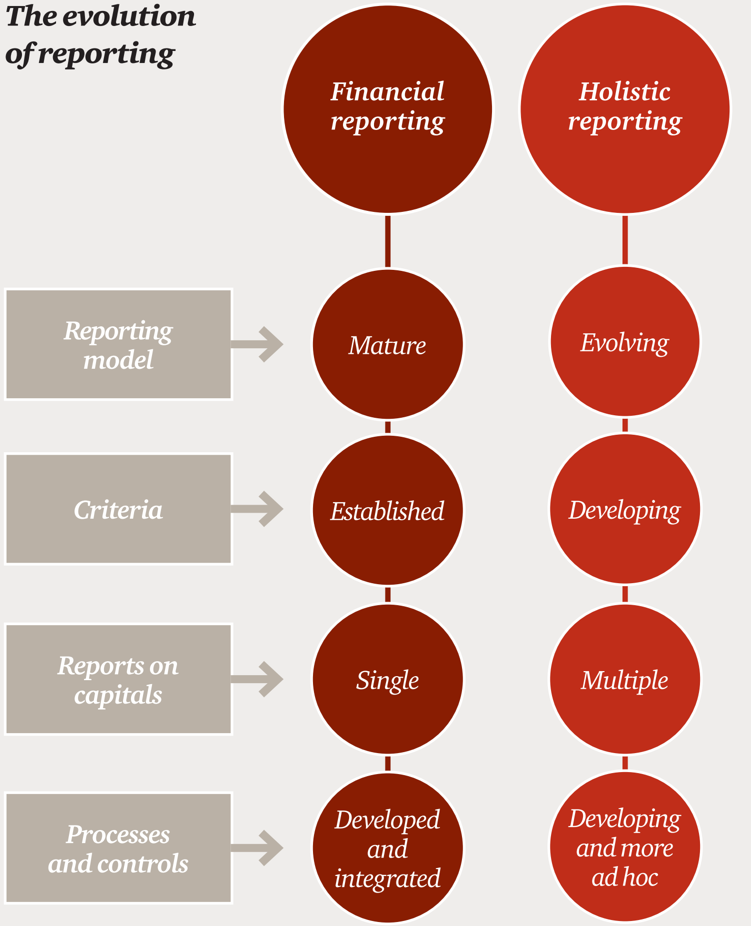
Internally, business models and information systems need to enable management to measure and manage total impact – taking into account a more holistic set of social, environmental, fiscal and economic dimensions, and looking beyond inputs and outputs to outcomes and impacts. This was the impetus behind the development of PwC's Total Impact Measurement and Management (TIMM) framework[1].

Many organisations are using non-financial information as a basis for decision-making and reporting. For most, however, their corporate reporting needs to be enhanced to give a clearer, more integrated and more forward-looking perspective of the business.

[1] *See PwC's White Paper: Measuring and managing total impact: A new language for business decisions at http://www.pwc.com/gx/en/sustainability/publications/total-impact-measurement-management/index.jhtml*

Some of the main differences as today's financially-orientated reporting broadens and expands to more holistic reporting are illustrated in *Figure 1*.

Figure 1:
The evolution of reporting



Organisations are already innovating to see what works for them.

... there are bumps in the road

Reshaping and broadening corporate reporting will be challenging. An initial hurdle that organisations face is to set appropriate metrics and KPIs aligned with their broader strategy and business model. Further challenges include:

- The need to invest in the development of appropriate skills to measure and manage performance in these broader areas;
- The availability of the 'right' information internally, which may often require more developed and integrated systems and processes;
- Accurate and meaningful quantification of data; and
- Determining how best to present a more integrated picture of their performance.

We recognise that organisations responding to the challenge are working in uncharted territory. And as they reshape and broaden their reporting, they will be working in areas where reporting frameworks and standards are often in the early stages of development and less defined, particularly for reporting an integrated picture of performance.

While these are by no means insignificant challenges, organisations have already been innovating to see what works for them. The momentum is building.

It's important that experimentation aimed at accelerating progress is fostered and encouraged.

Progress is being made

For several years, organisations, standard-setters and regulators have been reflecting on how to respond to the growing demand from investors and other stakeholders for more diverse, holistic and integrated information. Steps forward in external reporting have included moves to provide more information through initiatives such as strategic management reports; 'triple bottom line' reporting covering financial, social and environmental performance; and, more recently, the International Integrated Reporting (<IR>) Framework.

Governments and NGOs are also throwing their weight behind these changes. For example, the United Nations High Level Panel on the post-2015 Millennium Development Goals has recommended that all large organisations should report on their social and environmental impacts by 2030. By then this type of reporting, which is currently regarded as innovative and differentiated, ought to be mainstream – although to achieve that, all participants in the reporting value chain, including standards-setters, regulators, investors, NGOs, organisations and more – will need to believe in the importance of this new information and be committed to moving this agenda forward.

Overall, however, it's clear that moving to broader and more integrated reporting will be a journey rather than a single step. This is something that all of us need to bear in mind, as the balance gradually tips from the old metrics and mindset to the new ones.

And, inevitably, innovation in this area brings with it a degree of uncertainty, as organisations get to grips with what's needed. But this uncertainty is part of the process – and it's important that experimentation aimed at accelerating progress is fostered and encouraged.

The dilemma: building trust during the transition

As this process of transition and experimentation continues and the momentum builds, organisations find themselves on the horns of a dilemma in their reporting:

- On one hand, organisations recognise that they will build trust by providing greater transparency to stakeholders on how they manage different aspects of their value creation.
- But on the other, there is a natural reluctance to report – particularly externally – using measures and reporting models that are themselves evolving and therefore open to uncertainty and challenge.

This dilemma is heightened by concern over how others might react. For example, stakeholders have a natural scepticism about new information: how robust is it? How complete? Is it fact or spin? Also, in reality, different information reported by the same organisation may not have the same degree of reliability or credibility, because the information may not be equally 'robust' or – as we might say about numbers – 'hard'. The risk of legal challenge, especially in highly litigious societies, can have a chilling effect, particularly in the context of more forward-looking information where the outcomes may not always prove to be in line with management's expectations. And these are just a few of the barriers to adoption among other ideological, psychological, institutional and cultural hurdles.

Furthermore, without insight into the characteristics of a specific piece of information, or the process used to create it, there will always be uncertainty about it – and that uncertainty may undermine trust in the information itself. In turn, any doubts about the reliability of some of an organisation's reported information, or a perception of spin, may taint perceptions of the quality of the organisation's entire corporate reporting.

Today's assurance model...

So, how can organisations retain and build stakeholders' trust in their disclosures during the transition to a new form of reporting? An obvious answer might seem to lie in the traditional assurance model that underpins the independent financial statement audit and has been translated into today's assurance engagements.

At the risk of being overly simplistic, the assurance model in use today is based on the auditor measuring or evaluating the subject matter against set criteria in order to express a conclusion on it. Crucially, it implicitly assumes there is a mature, or at least reasonably mature, reporting model. To be more specific, it assumes there are robust, constant and 'suitable' criteria that can be applied – and that using these criteria in the same circumstances will produce substantively the same result.

Characteristics of today's assurance model

- *Predicated on a mature reporting model*
- *Requires 'suitable' criteria that are capable of reasonably consistent evaluation or measurement of a subject matter*
- *Evaluates or measures performance against the defined criteria*
- *Assurance is obtained through gathering evidence*
- *Results in evidence-based conclusions on the subject matter as a whole*
- *Overall conclusions that are well-developed and reasonably understood in the context of those subject matters (e.g. 'true and fair view', 'fairly presented')*

...is not always an easy fit with evolving broader reporting

Today's assurance model has already been applied to broader forms of reporting. In addition to the financial statement audit, many organisations have also sought assurance on specific systems, processes or KPIs and other metrics in order to build robustness and stakeholder confidence in them.

However, not all information in broader reporting is yet 'assurable', or 'auditable' in a more traditional sense, as the systems, controls and measures may not yet be sufficiently robust. We also don't yet know what the equivalent of a 'true and fair view' is for an organisation's broader reporting as a whole – if that is even the ultimate aim.

That's not to say that assurance on a broader set of systems, processes, KPIs and other metrics isn't valuable and what we should ultimately be aiming for. As soon as information is able to be externally validated in accordance with today's assurance model, then that assurance will have value – by engendering greater confidence in the information among stakeholders. The process of evaluating whether an organisation's reporting is ready for such an engagement is also valuable in itself, because it highlights where the organisation's underlying systems and processes need to be made more robust.

However, in practice, it's still fair to say that the established assurance model is not as supportive as it could be of innovation and experimentation in corporate reporting:

- The need for robust 'suitable' criteria can discourage experimentation, particularly in external reporting.
- The assurance provided is often limited to the more developed aspects of their reporting.

- Because the information is often 'softer', reports will more frequently need to include caveats on the information itself or on the conclusions on that information.
- There is still a perceived stigma associated with a qualified opinion when reported information fails to fully meet the criteria, or when it wasn't possible to obtain sufficient appropriate evidence.
- Although assurance reports in some new areas have included more narrative (e.g. AA1000 reports), the primary focus on a 'pass/fail' conclusion provides little scope for recognising ongoing improvement as an organisation innovates and experiments with its reporting.

The established assurance model is not as supportive as it could be of innovation and experimentation in corporate reporting...

So, rather than helping an organisation build trust as it tries to move forward with expanding its corporate reporting, today's assurance model can – somewhat ironically – either discourage organisations from making the effort and taking the risk in the first place, or raise questions that might actually serve to undermine trust in all their reporting.

There is little doubt in our mind that at the right stage in the development of an organisation's reporting, there will be a role for assurance as we know it today. But perhaps there is another way of applying auditors' expertise and professional judgement that is more supportive in the early stages of an organisation's development towards broader, more integrated reporting.

Figure 2: ***There are challenges in applying today's assurance model to broader reporting***

Is there another way?

We believe the answer is ‘yes’. The way forward lies in challenging current concepts to think differently about how trust can be built in an organisation’s emerging and evolving reporting – enabling organisations to embark with confidence on the journey to credible and joined-up reporting on the full range of measures that matter in their business.

To achieve this goal, we tried turning the equation round. What if, rather than providing a conclusion on how an organisation’s reporting measures against criteria, we were able to provide insight that lets people look behind the numbers to enable them to decide for themselves the degree of trust they put in the information? In other words using transparency to promote and support trust.

Information doesn’t have to be ‘hard’ to be valuable and credible. But you do need to know how ‘soft’ it is, and to understand what type of information it is and the context in which it has been developed.

Let’s crystallise further what this innovative model might look like in terms of its key characteristics. In our view, such a model would be based on applying informed professional judgement and:

- Multi-dimensional – in the sense that it tells a story about the maturity of the organisation’s reporting across a number of dimensions;
- Information-rich yet simple – and made more accessible by including a visual representation supported by commentary;
- Able to provide insight into what lies behind the numbers – not just whether the numbers are ‘right’ or ‘wrong’, but at the same time could provide links to areas in which traditional assurance has been obtained; and
- Able to be applied consistently across organisations.

What all these characteristics point towards is a model that is accessible and understandable ‘at a glance’, enabling it to remain simple and user-friendly while making more detail available and being able to handle a vast array of different types of information.

The overall aim would be to enable the organisation to be transparent about where it is on its reporting journey. And with the benefit of informed professional insight on the maturity of information, readers can make their own informed decisions on how they use – and how much they trust – the information, knowing how ‘soft’ or ‘hard’ the information is.

It’s important to stress here that we are not talking about replacing the existing assurance model. We’re looking to complement that model, by applying auditors’ expertise and professional judgement in a different way in these new and emerging areas where it is not yet possible to provide assurance as we know it today in a comprehensive way.

Characteristics of an innovative model:

- *Multi-dimensional*
- *Information-rich yet simple*
- *Insight into what lies behind numbers*
- *Consistent*

How might it work?

For the different sets of information reported by an organisation, (e.g. financial, environmental, social, economic and governance – referred to as 'capitals' by some) the model could show the relative level of maturity of each set based on the following dimensions:

- The degree of inherent measurement uncertainty;
- The stage of development of the reporting frameworks;
- The integrity of the information;
- The consistency of the reporting;
- The transparency of the information (i.e. whether the information reported externally is the same information that is reported and used internally); and
- The extent of external validation.

For the complete report, it could also show the balance and integration of the information, including:

- The extent to which the reported information explains the significance of the different sets of information (including related risks) in relation to the organisation's strategy;
- The connectivity between and interdependencies of the information; and
- The links between the different reports, irrespective of the media used.

Dimensions:

- *Measurement uncertainty*
- *Reporting frameworks*
- *Integrity*
- *Consistency*
- *Transparency*
- *External validation*

And for the complete report:

- *Integrated*
- *Balanced*

For each dimension, we believe that it is possible to show how mature the organisation's reported information is along each dimension using defined calibrations.

Narrative could provide greater insight into the basis for judgement on the relative level of maturity of the information. A comparison can be made here to the model of commercial due diligence reporting, which already provides insight through informed judgement and narrative in a narrower set of circumstances. Of course, there may be questions regarding whether the auditor is stepping into providing original information about the organisation – an issue that has been vexing in the auditor reporting debates. However, we believe that it is worthwhile considering how what is done in due diligence engagements can be leveraged in developing the new model, as well as the safeguards that may be needed to avoid overstepping boundaries.

Determining which information is relevant to both management and various external stakeholders is another important dimension to consider.

Some organisations may have already put in place a number of processes to identify the relevant information required by management and various external stakeholders. Ideally, these management information and reporting processes will be built on a clearly-articulated strategy that reflects the organisation's risks, opportunities and KPI's. In some cases, these processes may be supported by a stakeholder engagement programme to help determine and shape the reporting agenda, together with a feedback loop to provide an understanding of how the reporting can be improved.

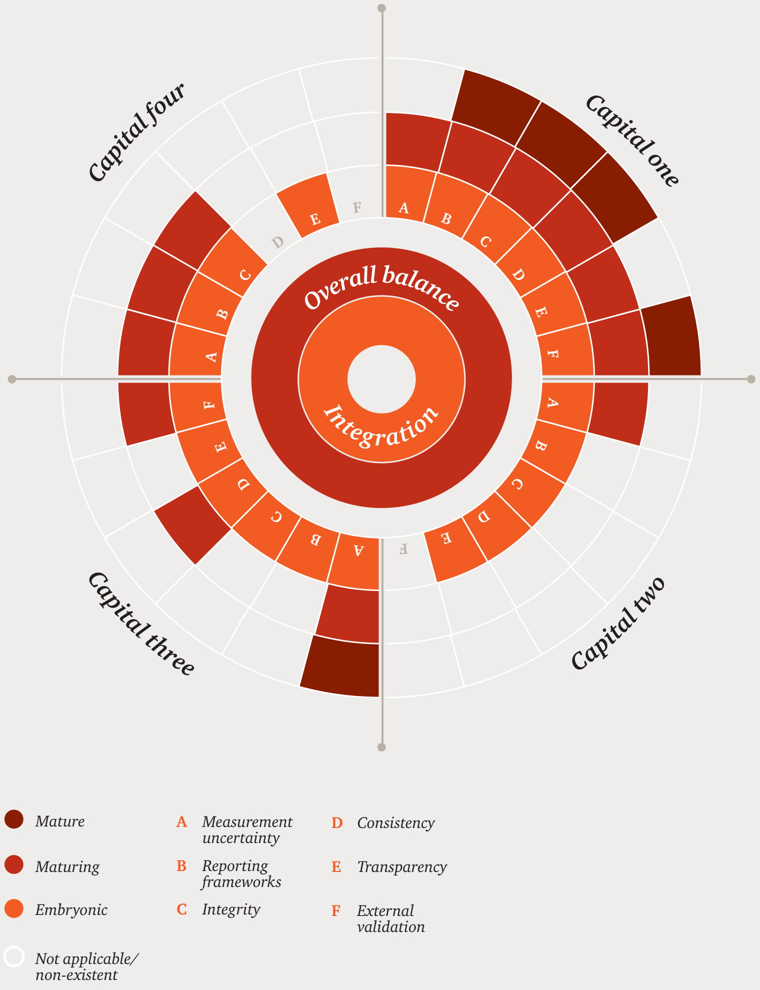
To a certain extent, an organisation's external stakeholders will form their own view of how effective the organisation has been in determining what information to report, as well as on what is actually reported: from their own perspective, is it relevant, insightful and comprehensive? We believe, however, that there is an opportunity to consider how insight into the maturity of these processes could be provided to users and we think this is something to be considered for the future. However, at the current stage of development of our conceptual thinking, we believe this new approach can provide the greatest value by focusing on how to provide insight into the maturity of the reported information itself, leaving the assessment of the relevance of the information to the stakeholder, at least for the time being.

This doesn't mean that relevance is not reflected in the proposed model. A key dimension in the model will be transparency – providing insight into whether the information reported externally is the same information that is reported and used internally.

For each information set, or capital, (e.g. financial, social, environmental), the model would show the relative level of maturity across a number of dimensions (e.g. integrity). Each dimension would be calibrated from 'embryonic' to 'developing' to 'mature'. Similarly, the same approach would be applied to the balance and integration of the overall report. A range of considerations would be applied to judge the maturity on each dimension.

The report would be likely to include a visual representation supported by commentary. This would provide an overall view together with narrative that provides insight into the basis for judgement on the relative level of maturity of the information.

Figure 3:
Insight into the maturity of an organisation's reporting



How would this new approach add value?

This new model would be valuable in different ways for different stakeholders. Users would benefit from:

- Insight into the context of the information, based on the view of assurance professionals;
- A multi-dimensional view, providing greater insight into attributes that are important for building trust;
- An understanding of where an organisation is on its journey towards broader and more integrated reporting; and
- Insightful and more timely information, as the model will give management greater confidence to broaden their reporting earlier in its development.

For preparers, an independent professional view on the maturity of the organisation's reporting will provide:

- Opportunities to earn users' trust through transparency in what they report, the journey they are on and the stage they are at;
- Insight into investment priorities to address gaps in critical areas of their business reporting; and
- The basis for a more open, informed and transparent dialogue with their stakeholders about their performance across all dimensions.

Testing our approach with Integrated Reporting

To illustrate how our new approach might work in practice for an organisation's external corporate reporting, we've tested our thinking in relation to the International Integrated Reporting (<IR>) Framework published in December 2013 by the IIRC. The IIRC's definition of Integrated Reporting, shown in the panel below, clearly embraces the broader business and stakeholder agenda we are looking to support organisations in pursuing.

According to the IIRC, an integrated report is intended to be more than a summary of information in other communications; at a minimum it should make explicit the connectivity of that information, and will often provide an 'entry point' to other, more detailed information to which it is linked.

Core to the IRRC's Framework are the critical sets of information, termed 'capitals', that reflect the resources and relationships used and affected by the organisation. The six capitals envisaged in the Framework are: financial, manufactured, intellectual, human, social and relationship, and natural. Not all capitals are necessarily equally relevant or applicable to all organisations, but for the purposes of this illustration we will include all six.

What is Integrated Reporting? The IIRC's view

"Integrated reporting is a process, founded on integrated thinking, that results in a periodic integrated report about value creation over time, and related communications regarding aspects of value created by an organisation."

In addition to providing deeper insight into a particular report, the model could also do the same with an organisation's overall corporate reporting, again from an external or internal perspective.

As *Figure 4* shows, combining our model with the IR Framework provides the user with insight into the degree of maturity of reporting for each of the six capitals. It also provides insight into the degree of balance and integration across the organisation's reported capitals.

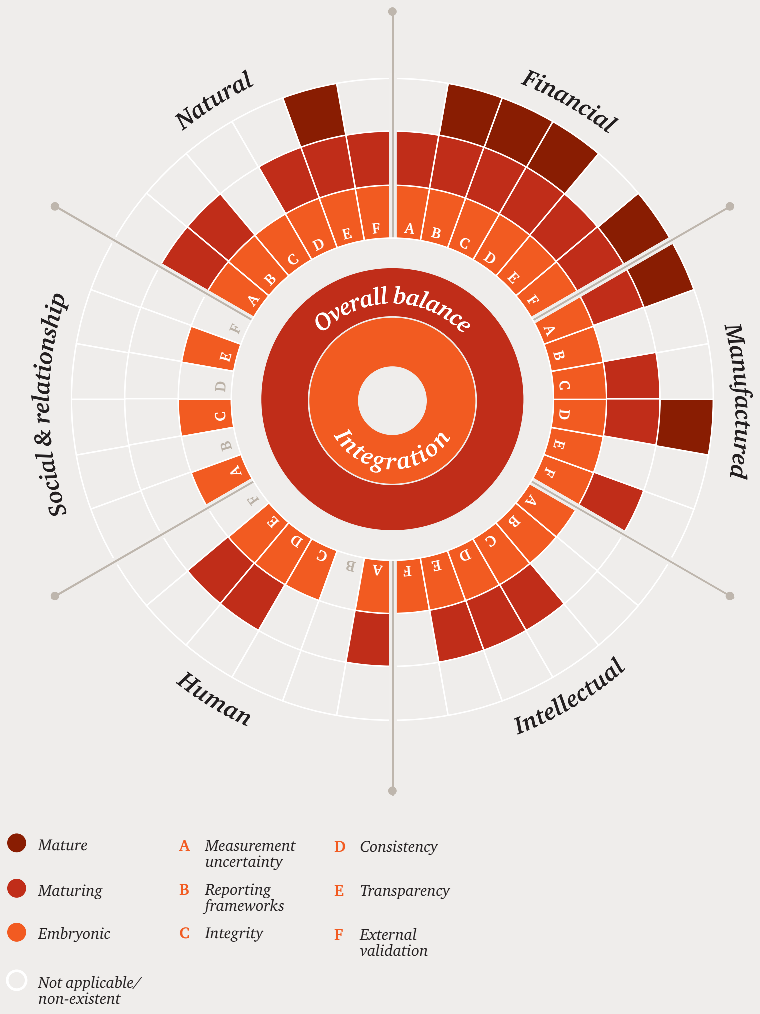
At whatever stage an organisation may be on its journey along the IR maturity curve, these insights enable its investors and other stakeholders to see behind the information – both financial and non-financial – to understand its characteristics, source and maturity. This visibility provides them in turn with a basis to reach their own informed decision on the degree of trust they put in the information.

How else might the model be applied?

In addition to its use with Integrated Reporting, we believe that this approach could be applied to a broad range of corporate reporting frameworks. It has the flexibility to accommodate different types of information and reporting. And while the thinking behind it is targeted primarily at external reporting, it is equally applicable to an organisation's internal reporting.

For example, it could be applied to management reporting on the TIMM dimensions measuring the social, environmental, tax and economic impact of their activities. And in addition to providing deeper insight into a particular report, the model could also do the same with an organisation's overall corporate reporting, again from an external or internal perspective.

Figure 4:
Insight into the maturity of an organisation's integrated reporting



So…what now?

Organisation's internal and external reporting must evolve to reflect the new demands of a changing world – and how we think about building trust in that information as it evolves need to evolve with it. We believe that there is a role for the assurance profession to support and accelerate this journey. The idea we have presented here is clearly still very much a work in progress, and there will be valid questions over how it might work. However, we believe it has tremendous potential to create enhanced value both for users and preparers of corporate reporting.

There is much more development to be done. We'll be looking to work closely with organisations and other interested parties to further develop this thinking and take it forward.

We look forward to finding out whether others share our view. With this in mind, we would welcome and value your responses to the thinking we've put forward in this paper. If you would like to share your thoughts with us, please contact:

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