INCPAS BOARD TASK FORCE

INTEGRATED REPORTING WHITE PAPER

November 11, 2012

Board Members

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Background Information

During the fall 2011 meeting of the INCPAS Leadership Cabinet/Emerging Leader's Alliance, volunteers were requested to prepare a response to the International Integrated Reporting Council (IIRC) discussion paper. The following individuals made the commitment to help with this effort. Mike Barker provided staff assistance to this group.

Michael D. Bedel, CPA
Karen Conner, CPA
Debra S. Deckard, CPA, CFF, CSEP
Brian K. Hostetter, CPA
Timothy C. Musholt, CPA
Tabitha R. Salati, CPA, CFE
Rachael Sarson, CPA
Tom Wadelton, CPA, CGMA

This group met via conference call on a several occasions and a response was prepared and submitted by the mid-December 2011 deadline. The INCPAS was the only state society to address this issue. Both the IIRC discussion paper and the response are incorporated into this document as Exhibit 1 and Exhibit 2, respectively.

After reviewing the response and discussing integrated reporting at Board meetings, in addition to the spring 2012 Leadership Cabinet/Emerging Leader's Alliance meeting, the INCPAS Board decided to form a task force to explore the topic of integrated reporting in further detail.

Integrated Reporting Task Force Charge

The task force was charged with the following items:

1. Become content experts on the topic. As a result of task force discussions and related research, report to the board of directors at the November 2012 retreat with notes related to implications for the future of INCPAS planning (SWOT, heat map, scenario plan) and possible impact on members, CPA firms and industry employers.

2. Provide recommendations for INCPAS actions, if any.

This discussion paper serves as evidence of the task force's discussions, conclusions, and recommendations.

Integrated Reporting Definition

At the first meeting of the task force, the group unanimously agreed (after reviewing three proposed definitions) to the following definition for integrated reporting. This definition was taken from the IIRC website.

Integrated Reporting brings together the material information about an organization's strategy, governance, performance and prospects in a way that reflects the commercial, social and environmental context within which it operates. It provides a clear and concise representation of how an organization demonstrates stewardship and how it creates value, now and in the future. Integrated Reporting combines the most material elements of information currently reported in separate reporting strands (financial, management commentary, governance and remuneration, and sustainability) in a coherent whole, and importantly:

• shows the connectivity between them; and

• explains how they affect the ability of an organization to create and sustain value in the short, medium and long term.

<u>International Integrated Reporting Council Highlights</u>

The following italicized paragraphs are excerpts from the IIRC website (theiirc.org).

The International Integrated Reporting Council ('the IIRC') is a powerful, international cross section of leaders from the corporate, investment, accounting, securities, regulatory, academic and standard-setting sectors as well as civil society.

The IIRC is chaired by Professor Mervyn King. Paul Druckman is Chief Executive Officer.

The mission of the IIRC is to create a globally accepted Integrated Reporting framework which brings together financial, environmental, social and governance information in a clear, concise, consistent and comparable format. The aim is to help with the development of more comprehensive and comprehensible information about organizations, prospective as well as retrospective, to meet the needs of a more sustainable, global economy.

The principal role of the IIRC is to:

- *Reach a consensus among governments, listing authorities, business, investors, accounting bodies and standard setters for the best way to tackle the challenges of Integrated Reporting;*
- *Identify priority areas where additional work is needed and provide a plan for development;*
- *Develop an overarching Integrated Reporting framework, which sets out the scope and key components of Integrated Reporting ('the <IR> Framework');*
- *Consider whether integrated reporting should be voluntary or mandatory;*
- *Promote the adoption of Integrated Reporting by relevant regulators and report preparers.*

The IIRC will have forty two council members when fully staffed. Current membership includes the chairs of the Big Four accounting firms and the CEO's of BDO and Grant Thornton. A complete membership listing is attached as Exhibit 3.

The IIRC Board of Directors is comprised of eight members:

Professor Mervyn E. King, Chair, Senior Counsel and former Judge of the Supreme Court of South Africa and also serves as the Chairman of the King Committee on Corporate Governance

Ian Ball, CEO of the International Federation of Accountants

Jane Diplock, Director of Singapore Exchange Limited

Paul Druckman, CEO of the IIRC

Leslie Ferrar, Treasurer, The Prince's Accounting for Sustainability Project

Jessica Fries, Executive Chairman, The Prince's Accounting for Sustainability Project

Ernst Ligteringen, CEO of Global Reporting Initiative

Christy Wood, Chairman, International Corporate Governance Network

Based on the composition of the Board, it is very clear that the IIRC represents a collaborative effort of the leaders in sustainability/integrated reporting. We will briefly cover the The Prince's Accounting for Sustainability Project, International Federation of Accountants, King Committee, and the Global Reporting Initiative in the following section.

The IIRC has prepared a draft integrated reporting framework which is included as Exhibit 4.

Other Major Players

The Prince's Accounting for Sustainability Project

International Federation of Accountants

Global Reporting Initiative

King Committee

Key Questions Addressed

Who is preparing integrated reports currently? Why are companies preparing such reports?

As addressed in the previous section, many companies are providing substantial information related to their sustainability efforts currently. Many of these same companies are championing the concept of additional integrated type reporting and going beyond the traditional financial and sustainability reporting.

Currently, over seventy companies are participating in a pilot program with the IIRC. Among these firms are six from the United States.

Edelman
Clifts Natural Resources
Microsoft
Prudential Financial Corporation
Clorox
Coca Cola

We believe the reasons why firms are participating are varied but mainly fall within the following categories.

1. Morally, socially responsible course of action

Many of these companies are truly committed to ensuring that developed country norms in regards to working conditions, employee treatment, waste disposal, etc., are followed by both their own company and suppliers in less developed areas of the globe.

2. Competitive Advantage

It appears that most of the large stock exchanges are developing indexes for companies that are at least developing and implementing "sustainable" strategies. This could easily become an investor preference when determining which companies or fund of companies to invest in.

3. Develop/meet emerging trends

Based on our review of literature, we believe that the movement towards integrated reporting is real. While the implementation time may be a decade or longer, we believe that many of the current firms engaged in this process want to shape the ultimate framework used. Therefore, these companies are taking the lead in developing the framework for integrated reporting.

4. Risk Management

For many firms, integrated reporting is another step in their enterprise risk management systems. Firms are taking a proactive approach to these issues rather than waiting on something to become a major news item or environmental problem. Social and environmental problems in relatively remote corners of the world can become instant issues for firms given the relatively recent advent of social media.

What credibility do CPAs have in integrated reporting? Why?

For over a century, CPAs have been the trusted by the public and investing community to provide opinions on the published financial reports. CPAs continue to enjoy the reputation as the independent arbiters of the adequacy and quality of the management's reports today.

We believe that opining on integrated reports is a natural extension of the existing work that CPA firm's perform today. An engaged CPA firm is familiar with the entire revenue generating process of their clients. In order to reach the appropriate conclusions on the adequacy of the internal controls, the CPAs on the engagement need to understand the core values of the firm. It is only reasonable to reach the conclusion that other aspects of integrated reporting would be under the purview of CPAs.

CPAs understand how to plan and rely on work that is performed by individuals with disciplines outside of accounting and auditing. Other professions lack this necessary skill. For example, environmental engineers are fully competent to determine the amount of waste products produced by a firm. However, engineers would typically be at a loss to determine how to incorporate their conclusions in an integrated report with all of the other disciplines. CPAs already know how to incorporate the work of others into comprehensive reporting documents.

We are concerned that if we fail to embrace this emerging field of accounting and auditing, CPAs could lose their public perception as the trusted advisor and watchdog of the investors. Our value proposition could be substantially diminished if we allow other players to enter this market uncontested. If the public becomes accustomed to reading integrated reports without some type of CPA assurance, it only logical to conclude that the public perception of CPAs will decline over time.

What competencies will CPAs need to develop? A. Who will provide the learning resources? How will they be provided?

As mentioned previously, it will be critical for CPAs to understand their client's value proposition and core values. Since the successful promulgation of these core values will be a key component of the integrated report, CPAs will need to ensure that expertise is available in the following areas:

- Industry knowledge—including specialized technology and practices.
- Human resources
- Environmental resources
- Corporate governance
- Other stakeholder issues

We believe that many small and mid-size firms will, by necessity, be forced to partner with other firms (including non-CPA firms) to obtain the expertise necessary to complete all aspects of this type of work. The final outcome may be that small and mid-size CPA firms specialize in certain aspects of integrated reporting and then provide their expertise to larger CPA firms. These larger firms may be ultimate provider of assurance on integrated reporting.

Large organizations will use this integrated reporting to not only report results but will also have the ability to market their organization to potential customers. In addition, we believe that integrated reporting will be a key recruiting tool for the human resources personnel at these organizations.

Based on the current direction of integrated reporting, the following topics will be included in integrated reports:

- Governance
- Environmental - Water stewardship, usage KPI's, carbon emissions, sustainable agriculture, or resource renewal, etc.
- Human Rights - policy compliance (even supply chain), worldwide.
- Product responsibility - product lists and uses.

- Labor Practices - safety programs, education, salary and benefits, upward mobility, equal opportunity. Inclusiveness, turnover rates, health
- Sustainability, packaging, reducing petroleum recycling, packaging mixes KPI's (glass, paper, metal), etc.
- Society - corporate giving- categories of philanthropy
- Economic Contributions - Salaries, dividends, investment, Income taxes, total

As integrated reporting moves closer to implementation, we believe that the AICPA, the INCPAS, and the IIRC will have significant opportunities to provide training and other resources to ensure a smooth transition.

How does the future of financial reporting relate to this topic?

The future state of financial reporting is in a state of flux. Currently, the following discussions are in progress:

- Challenges of IFRS acceptance and adoption
- Private vs. public company reporting in US
- General consensus that current historical view reporting needs revisions, it does not meet the needs of many "non-asset" based companies (Google for example)

It appears that the profession is heading into the future in which change is the only certainty.

Does integrated reporting only relate to public companies, if it relates at all?

We definitely believe that public companies are the primary focus from a stakeholder perspective of integrated reporting. These companies are typically larger and the have the staffing and resources necessary in order to comply with these new areas of reporting. In addition, public companies have the potential to offset the increased costs by sharing additional information that may reduce their cost of capital.

In addition, we offer the following questions/comments for further discussion and analysis:

- Non-public companies may be reluctant to incur the costs associated with integrated reporting.
- Consider a "lite" version that addresses the more basic environmental, social, and governance policies for non-public companies
- Will large companies require their vendors to comply with integrated reporting standards? More likely to create their own questionnaire that addresses their specific concerns and is not as much of a cost burden.
- How will adding integrated reporting to an already bloated F/S and disclosure make it more meaningful?

- Are companies going to disclose potential negative risks that may influence their perception in the market place or meaningful strategies for their competitors to view?
- The educated investors are already collecting data regarding environmental, social, and corporate governance before they invest, so what is the purpose?
- In a world where the primary concerns are next quarter's earnings, how much attention will integrated reporting receive versus trying to improve overall financial reporting?

Can U.S. companies stay competitive in a global environment without embracing this concept?

We believe that changes are occurring, and will continue, in the overall reporting required of public companies. We expect that integrated reporting of some type will be required at some point in the future; however, it may be a decade or more into the future.

Different requirements exist and are evolving in different countries. Therefore this will affect larger international entities first (and has already had effect on many). In some cases these companies have already had to embrace this concept due to the rules thrust upon them in foreign jurisdictions.

As "environmentalism" grows as a movement, more investors will require the kind of information found in integrated reports before they will invest in a company. As a result, the ability to attract capital requires that integrated reporting be adopted by those companies that expect to raise capital from the general public. Reporting has become fragmented, with the traditional financial report being supplemented by additional reports dealing with governance sustainability, environmental impact, etc. These reports are cumbersome in their length and detail, yet there are gaps in the information provided. Someone will eventually combine these reports into a single, complete, and concise integrated report. If it is not our profession, we will lose relevance as a provider of a portion of the overall report. It is possible that this issue will be part of the international convergence of accounting standards. If we are not "at the table" our CPA brand will suffer internationally.

Small and mid-sized firms may or may not be affected depending on their clientele, future U.S. regulations, and dependence of their clients on external equity markets.

<u>Recommendations</u>

Our recommendations can be broken down into the following three categories: Monitor, Educate & Advocate.

1. Monitor the development and implementation status of integrated reporting.

The task force recommends that the Board of Directors appoint a small group of Emerging Leaders Alliance/Leadership Cabinet members annually to monitor the integrated reporting issue. This group should work with INCPAS staff (typically the CFO) to review all key material, timelines, etc., established by the IIRC. In addition, this group should respond to pertinent requests for information and comments and provide periodic reporting to the entire Board.

2. Provide educational opportunities for the membership.

The task force convened above should also review the AICPA and INCPAS integrated reporting educational offerings on an annual basis and recommend strategies related to integrated reporting. We recognize that the initial educational emphasis may be focused on raising topic awareness. However, as more progress is made on integrated reporting, additional training opportunities may arise.

3. Advocate for the implementation of integrated reporting.

The task force recommends that the INCPAS advocate for the continued evaluation of the benefits and costs associated with integrated reporting. The task force believes that integrated reporting will provide valuable insights into an organization's value creation process and ultimately aid the investing community (and others) to determine the pertinent market valuation.

4. Encourage the AICPA to develop pertinent marketing and education opportunities.

The task force recognizes that the INCPAS can play a strong role in the integrated reporting dialogue; however, if the process is to be effective in the United States the AICPA must provide a strong leadership role. The task force recommends that INCPAS leadership continue to encourage the AICPA to provide leadership in this area. The AICPA should take the lead in developing marketing/awareness and professional development programs in this area.

The task force recognizes that the AICPA has been a proponent of expanded disclosures for over two decades. It is our understanding that staff and financial resources have been dedicated to assisting the IIRC in the development of the integrated reporting framework. We applaud these efforts to date; however, we believe that as further progress is made on this topic the ACIPA will need to step up its marketing and educational efforts.