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Professor Kerstin Lopatta
Acting Chair
Sustainability Reporting Board
EFRAG

Dear Professor Lopatta

IRC of South Africa Comment Letter to EFRAG on ESRS 1 and ESRS 2

The Integrated Reporting Committee (IRC) is the national body in South Africa promoting and developing integrated reporting and integrated thinking. We have endorsed the *International <IR> Framework* as global best practice guidance on preparing an integrated report. In South Africa, the preparation of an annual integrated report is a recommended practice of the *King IV Code of Corporate Governance Practice* (King IV). The King IV Code falls within the Listings Requirements of the JSE. The IRC produces technical information papers and FAQs for preparers of integrated reports; these are available on www.integratedreportingsa.org

We applaud you for your efforts in promoting sustainability disclosure and reporting for sustainable development. We have taken the liberty of looking at your Exposure Drafts, in particular *[Draft] ESRS 1 General principles* and *[Draft] ESRS 2 General, strategy, governance and materiality assessment*, from an integrated reporting and integrated thinking perspective and offer some high-level comments in Appendix A for your consideration.

With best regards

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Appendix A

ESRS 1 General Principles

Users

The Exposure Draft's positioning of the users of sustainability reporting being all stakeholders, which includes investors, is appreciated. An organisation's governing body is responsible to the organisation, and through that, to the organisation's stakeholders.

Double materiality

We agree with the Exposure Draft's positioning of double materiality in reporting on "sustainability impacts, risks and opportunities". We see this as encompassing stewardship by the organisation's governing body and accountability through balanced and transparent reporting.

Impact materiality and financial materiality

As explained in the Exposure Draft a matter is material if: "A sustainability matter meets the criteria of double materiality if it is material from an impact perspective or from a financial perspective or from both". Different definitions are given for "impact materiality" and "financial materiality". The latter refers to "future cash flows" and "enterprise value". It can be argued, however, that most significant impacts on society and the environment will at some stage over the short, medium or long term affect the organisation's "future cash flows" and "enterprise value". The Exposure Draft acknowledges that the two views of materiality are intertwined, but further clarity may be needed to avoid confusion.

Time horizon

We understand that the Exposure Draft has defined periods for the short, medium and long term as an aid to comparability, however, the periods may not be appropriate for all sectors, for instance telecoms versus mining. Perhaps consider allowing flexibility provided there is explanation of the variation by the organisation.

Enterprise value creation versus value creation, preservation or erosion

In the Exposure Draft, paragraph 54, refers to "...contribute to the creation/maintenance of enterprise value. The latter factors are generally referred to as 'capitals' in frameworks promoting a multi-capital approach". We point out that "enterprise value creation" is different to "value creation, preservation or erosion". The former refers to value created for the organisation itself. The latter refers to the consequential changes in the six capitals (encompassing society and the environment), which increase or decrease as a consequence of the organisation's business activities and products over time. This concept is explained in the *International <IR> Framework (2021)*, a multi-capitals framework.

The integrated report

We see a valuable place for a concise integrated report in corporate reporting going forward because it is the only report in the corporate reporting suite that affords an overall and integrated view of the organisation.

The integrated report offers users the organisational overview; its external environmental factors; the business model explaining the inputs relied on and the consequential effects on society and the

environment over time; the overall and holistic strategic objectives performance, risks and opportunities; and, the overall governance structure and processes.

The integrated report serves as a useful starting point to users in understanding the organisation in its entirety, after which other detailed, subject-specific and lengthier reports can be accessed.

The experience of South African organisations, who have prepared integrated reports for over ten years, is worthy of sharing. While integrated reporting has no doubt rendered external benefits, it has also rendered significant internal benefits. Most notably, It has assisted them to embed integrated thinking in their organisations and move away from silo'd sustainability and financial thinking. It has shifted the internal mindset away from the short-term financial to the short, medium and long term view of seeing the consequential cause and effect relationships across the capitals.

As defined in the *International <IR> Framework (2021)*, page 53, integrated thinking is: “The active consideration by an organization of the relationships between its various operating and functional units and the capitals that the organization uses or affects. Integrated thinking leads to integrated decision-making and actions that consider the creation, preservation or erosion of value over the short, medium and long term”. The definition acknowledges the effects on the capitals and that these effects may be positive, neutral or negative over time.

With regard to the popular and topical use of the term ‘connectivity’, we point out that the integration reflected in the integrated report is different to connectivity, with the latter referring to the connectivity among the various factors that make up aspects of the organisation and the former seeing the organisation as an integrated whole.

The disclosure options

In the Exposure Draft, paragraph 8, states: “The undertaking shall present sustainability information in Sustainability Statements that are part of the management report”. Three different disclosure options are allowed as set out in paragraph 148. The disclosure option (b), although stated as not being the preferred option, allows for sustainability information to be disclosed/integrated with other ‘like’ information, for instance, sustainability governance information can be housed within the organisation’s overall governance statement.

Following on our earlier points, we suggest that an integrated approach to reporting should be encouraged. Separate reports limit an integrated view, and can limit the accessibility of information for users who are interested in both financial and sustainability information and viewing the organisation as an integrated whole.

In South Africa, over the past decade, many organisations have worked on integrating sustainability matters throughout their organisations, for example, through a sustainability framework and strategy that is embedded in corporate strategy, governance and decision-making structures. The integrated report follows as a logical consequence of integrating sustainability matters at an organisational and operational level. The integration shown in the integrated report has also achieved greater awareness internally, while increasing visibility and improving understanding externally.

ESRS 2 General, Strategy, Governance, and Materiality Assessment

Value creation

The term “value creation” is used in the Exposure Draft, but consider using the full term of ‘value creation, preservation or erosion’ to highlight the inclusion of actual and potential negative impacts over time. Further, value creation for stakeholders is frequently mentioned, however, an organisation could have negative value creation (erosion) on certain stakeholder groups at some points.

Strategy and business model

Disclosure requirement 2-SBM 2: Consider including the links to risks and opportunities arising from the stakeholders’ views, interests and expectations. Also, information on the organisation’s quality of relationships with its key stakeholders is important information pertaining to the future of the organisation.

Disclosure Requirement 2-SBM 3: The requirement to link and explain impacts on society and the environment to the business model is applauded because this offers a more comprehensive view than a business model limited to showing only how the organisation makes its money. We suggest specifically including the time reference here, i.e. over the short, medium and long term.

Governance

Disclosure requirement 2-GOV 2: In paragraph 56, consider including disclosure of the information given to the governing body on the quality of organisation’s key stakeholder relationships throughout the year.

Materiality assessment of sustainability impacts, risks and opportunities

Disclosure requirement 2-IRO 1: In the description of the process to identify the material sustainability impacts, risks and opportunities, consider including disclosure of the timing of the process. For instance, the determination process could variably occur at the end of the reporting year, on an ongoing basis throughout the year, or at the beginning of the year with an update at the end of the year.

Appendix A - Defined terms

Business model: As it is currently stated, the definition is slanted to producing desired outcomes that aim to create value. We suggest re-phrasing to include reference to impacts, i.e. the actual or potential negative and positive impacts over time. This wording is then more aligned to the explanation given in Disclosure requirement 2-SBM 3.

Other comments

Assurance levels: While different assurance levels may apply to financial information versus sustainability information, it is suggested that audit/ assurance considerations should not determine reporting requirements. In South Africa, organisations address this issue by highlighting the different assurance levels (internal and external) adopted depending on the nature of the information disclosed. Integrated assurance (called combined assurance in South Africa) can usefully be applied to ensure the reliability of the sustainability information reported.