Are Integrated Reporting and IFRS competing frameworks?

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Abstract

Although integrated reporting emphasises the contemporaneous relationship between financial and non-financial capitals, its primary purpose is to explain how an organization creates value over time. This is similar to the purpose of management commentary, which is part of a general-purpose financial report. We compare and contrast the information requirements of an integrated report with the type of information that supplements the primary financial information in general purpose financial reports, prepared in accordance with International Financial Reporting Standards (IFRS). We examine whether the information in those reports is intended to be forward-looking and predictive, whether non-financial capitals can (and should) be monetized in order to facilitate integration, and whether the reporting boundary should be drawn in different ways to serve different purposes. We find that the International Integrated Reporting Framework and IFRS do not serve different purposes or apply different approaches, but that – in essence – they are competing frameworks. While IFRS has highly developed standards for reporting financial capital, neither has a well-developed approach for reporting any other capital.

Introduction

The International Integrated Reporting Framework (denoted in this chapter as the ‘<IR> Framework’ or ‘<IR>’) has emerged in recent years as a credible reporting framework. The

International Financial Reporting Standards (IFRS) are more firmly established. The IFRS Foundation states that “144 (87%) of jurisdictions require IFRS Standards for most domestically accountable companies” (IFRS Foundation, 2019). Although those Standards focus mainly on financial information, some Standards require entities to disclose information not directly related to amounts reported in the financial statements. Furthermore, the International Accounting Standards Board (IASB), the standard-setting body of the IFRS Foundation, has published guidance on producing management commentary to supplement and complement the financial statements.[i] In this chapter we assess similarities and differences between <IR> and the IASB’s requirements and guidance.

Our central question is the following: are the <IR> Framework and IFRS competing frameworks, or do they serve different purposes?

<IR> and General Purpose Financial Reporting

An integrated report is a “concise communication about how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term” (International Integrated Reporting Council (IIRC), 2013, p. 7). It looks beyond the reporting boundary of the financial statements by focusing on those risks, opportunities and outcomes that have a significant effect on the ability of the financial reporting entity to create value (IIRC, 2013, p. 20).

A General Purpose Financial Report (GPFR):

> provides financial information about the reporting entity’s economic resources, claims against the entity and changes in those economic resources and claims that is useful to primary users in making decisions relating to providing resources to the entity (IASB, 2018).

A GPFR includes general purpose financial statements and could include management commentary.[ii] General purpose financial statements are a “particular form of general purpose financial reports that provide information about the reporting entity’s assets, liabilities, equity, income and expenses" (IASB, 2018, para. 1.2, 1.12 and 3.2). Management commentary provides information about matters that could affect those elements. Management commentary:

> complements and supplements the financial statements by communicating integrated information about the entity's resources and the claims against the entity and its resources, and the transactions and other events that change them (IASB, 2010, para. 10).

Table 10.1 lists the elements of an integrated report set out in the <IR> Framework, alongside the elements of management commentary set out in the practice statement. Apart from some examples of the type of information that might be consistent with these elements, neither the <IR> Framework nor the IASB's practice statement set out specific metrics.

Table 10.1: Comparison of content elements

<IR> Framework	**Management Commentary**
Organizational overview and external environment Governance Business model Risks and opportunities Strategy and resource allocation Performance Outlook Basis of preparation and presentation	Nature of the business Objectives and strategies Resources, risks and relationships Results and prospects Performance measures and indicators

At first sight, it is not immediately obvious from Table 10.1 whether these two approaches are fundamentally different from one another, or if instead they differ in language but not in substance.

<IR> Framework

The IIRC has a Framework to "establish Guiding Principles and Content Elements that govern the overall content of an integrated report, and to explain the fundamental concepts that underpin them" (IIRC, 2013, p. 7). The objectives of the <IR> Framework are anchored on the financial capital of an entity and the information needs of investors. To that end, the

<IR> Framework sets out the six capitals that are intended to capture a complete picture of an entity: financial; manufactured; intellectual; human; social and relationship; and natural. We use the following notations to refer to these capitals:

$$(F, M, I, H, S, N)$$

where F=financial, M=manufactured, I=intellectual, H=human, S=social and relationship and N=natural.

An integrated report should provide information about these capitals, and the relationships and interactions between them. It is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or website content); rather, it makes explicit the connectivity of information to communicate how value is created over time (IIRC, 2013, p. 8).

The <IR> Framework is written to provide requirements and guidance for the preparation of an integrated report. The IIRC has not issued any standards on recognition or measurement principles for the six capitals. However, there are many bodies that develop standards related to non-financial capitals — such as the Sustainability Accounting Standards Board (environmental, social and governance), Global Reporting Initiative (sustainability) and the World Intellectual Capital/Assets Initiative (industry-specific key performance indicators (KPIs)). The IASB has standards for measuring and reporting financial capital. The <IR> Framework does not refer to any of these financial or non-financial standards.

IFRS Framework and Standards

The IFRS Framework sets out the objectives and qualitative characteristics of a GPFR, which apply to financial statements and management commentary.[iii] The IFRS Framework also discusses information specific to the financial statements.[iv] Similar to the <IR> Framework, the anchor is the financial capital of an entity and the information needs of investors.

The IFRS Framework is written mainly to help the IASB develop IFRS Standards that are based on consistent concepts. Although it is also intended to help preparers develop consistent accounting policies, that is limited to when no Standard applies to a particular transaction or event or a Standard provides a choice of accounting policies (IASB, 2010, SP1.1).

Financial statements

The IASB defines a complete set of financial statements as comprising the primary financial statements (financial position, profit or loss and other comprehensive income, changes in equity and cash flows) and the notes as "comprising significant accounting policies and other explanatory information" (IASB, 2019a, para. 1.10).[v]

Financial Statements convey information about an entity's assets, liabilities and equity, and changes in them (income and expenses). The IASB publishes Standards and Interpretations setting out how entities are required to recognise and measure these elements, and what information needs to be disclosed about individual elements. There are 42 Standards, 20 Interpretations and two Practice Statements currently in effect.

Most IFRS Standards include disclosure requirements. Some Standards specify that a particular element must be shown on a separate line in the primary financial statements, such as total property, plant and equipment. Many Standards require that the notes include a disaggregation of an element in the primary financial statement, such as the property, plant and equipment disaggregated into classes or the timing of the repayments of a non-current liability.

Some IFRS Standards require the disclosure of financial information about recognised assets or liabilities that supplements the recognised amounts. For example, IAS 40 *Investment Properties* requires entities that use the cost model to also disclose the fair value of investment properties. Similarly, IAS 16 *Property, Plant and Equipment* requires entities that use the fair value model to also disclose the amounts that would be reported under the cost model. For those entities using the cost model, IAS 16 encourages the disclosure of the fair value of the property, plant and equipment when this is materially different from its carrying amount.

Some of the disclosures relate to assets and liabilities that are not recognised, such as assets that have been fully depreciated but are still being used (IAS 16), contingent assets and liabilities (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) and synergies and intangibles that do not qualify for separate recognition when a new business is acquired (IFRS 3 *Business Combinations*). IAS 38 *Intangible Assets* requires an entity to provide a description of significant intangible assets that it controls but does not recognise as assets because they have not met the recognition criteria in IAS 38. The IASB plans to use its revision of the Management Commentary Practice Statement to consider what additional information about intangible assets should be presented in the management commentary because "[t]rying to capture the value of intangibles is a hugely subjective exercise and would pose enormous recognition and measurement challenges" (Hoogervorst, 2019b).

Entities are required to provide information about the composition of the reporting entity (group), whether some owners have interests in only parts of that group and the nature of restrictions the structure imposes on the ability to use assets, settle liabilities or use cash held in one part of the group (IFRS 12 *Disclosure of Interests in other Entities* and IAS 7 *Statement of Cash Flows*). Changes to the reporting entity, such as when it acquires a material new business, must be disclosed, including information such as the primary reason for the acquisition (IFRS 3).

IFRS Standards include several requirements about risks to which the entity is exposed. These include requirements to disclose information about the nature of, and changes to, risks associated with consolidated and unconsolidated structured entities (IFRS 12), how liquidity risk is managed (IFRS 7 *Financial Instruments: Disclosures*), and an explanation of demand risk and regulatory risk in relation to regulatory assets (IFRS 14 *Regulatory Deferral Accounts*).

Some of the disclosures relate to how the risks are managed, such as descriptions of collateral and credit enhancements. Entities are required to explain how their activities are organized. This helps users understand how management operates the business, by reporting information that is consistent with that segmentation (IFRS 8 *Operating Segments*) and that sets out how the entity manages its net assets and its financial capital (IAS 1 *Presentation of Financial Statements*).

The accounting policies used to recognize and measure the elements must be disclosed (IAS 1), as well as changes to them and the effects of new IFRS requirements not yet applied (IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). Information about uncertainties associated with some elements such as inputs that are sensitive to a fair value measure must be disclosed (IFRS 13 *Fair Value Measurement*).

There is a range of other disclosure requirements for information that is not reflected in the carrying amounts in the primary financial statements, such as the characteristics of pension plans (IAS 19 *Employee Benefits*), related party information (IAS 24 *Related Party Disclosures*), unfulfilled conditions on government grants (IAS 41 *Agriculture*) and a description of non-adjusting events outside of the reporting period (IAS 10 *Events after the Reporting Period*).

Overall, while the <IR> Framework calls simply for the reporting of financial capital, the requirements of IFRS set out - in comprehensive detail – precisely what financial capital means in practice. While there are some grey areas here, in that some disclosures go beyond the reporting of amounts recognised in the financial statements, there is nevertheless a high level of structure, consistency and clarity imposed on the reporting of financial capital. Moreover, this is done in a way that suggests no obvious difference between the meaning of financial capital in <IR> and in IFRS.

Management commentary

The IASB has a Practice Statement that sets out guidance on management commentary. The Practice Statement is being revised to "help investors better understand the financial impact of aspects of business performance that cannot be adequately captured in the financial statements" (Hoogervorst, 2019b). The project to revise the Management Commentary Practice Statement focuses on information that supplements the primary financial statements by providing information about matters that could affect those elements:

(a) the reporting entity's business model, strategy, risks and operating environment that explains the entity's current financial performance and financial position and provides insights into the entity's long-term prospects;

(b) activities that could affect the entity's future financial statements, such as intangible resources and relationships not recognised in the financial statements or information about environmental matters important for the entity's long-term success;

(c) non-financial performance metrics; and

(d) forward-looking information, such as forecasts and targets (IASB, 2019b).

The IASB states that this information is sometimes referred to as 'non-financial information' or 'pre-financial information'. In materials developed so far, the staff have used the term 'operational information' but are still considering whether that is the best label to use.

Although management commentary is part of a GPFR, IFRS Standards apply only to the financial statements. Some of the information required by IFRS Standards, such as how an entity manages risk, seems to be more consistent with the objective of management commentary than financial statements. The IASB seems to acknowledge this by allowing some supplementary information to be presented in management commentary and incorporated into the financial statements by cross-reference. However, this constraint limits how the IASB can develop disclosure requirements for supplementary information.

While the IASB does not refer directly to non-financial capitals, there are clearly links between natural capital and 'environmental matters important for the entity's long-term success', and between intellectual, human, social and relationship capitals and 'intangible resources and relationships not recognised in the financial statements.' Such links are also evident in calls by investors for 'non-financial performance metrics'. While these links are not specific, there is no obvious inconsistency here between the concepts in <IR> and IFRS.

Non-IFRS information

A distinct issue arising in an IFRS context is that many IFRS-compliant entities include, within their financial statements and management commentary, what is variously referred to as non-GAAP or non-IFRS information, or 'alternative performance measures'.

Alternative performance measures have become the subject of increased focus by securities regulators. IOSCO defines a non-GAAP financial measure as "a numerical measure of an issuer's current, historical or future financial performance, financial position or cash flow that is not a GAAP measure" (IOASCO, 2016). The European Securities and Markets Regulator published guidelines on reporting alternative performance measures in 2015 and the US Securities and Exchange Commission updated its guidance in 2016. Many securities regulators place constraints on the presentation of non-IFRS information. For example, they typically require that they: are not given more prominence than IFRS measures; have clear and unbiased labels; include explanations of why the measures are useful; provide a clear explanation of the basis of calculation; be used consistently; and be reconciled to IFRS measures. The IASB Chairman has also discussed concerns about non-IFRS information, which the IASB has discussed in its Disclosure Initiative projects (Hoogervorst, 2015, 2016).

There is a wide range of supplementary information reported, such as alternative measures of profit, per-store sales, customer churn rates, oil and gas reserves, and environmental information. The information about non-financial capitals anticipated by the <IR> Framework would be considered non-IFRS information. Some of the non-IFRS information is disclosed because regulators in some jurisdictions require that a company disclose the information in its annual report, such as a European requirement for companies to list all of their subsidiaries, associates and some other investments (EU Accounting Directive SI 2015/980).

While such information is ‘non-IFRS’, this means only that it stands outside the formal recognition and measurement criteria required in the financial statements. It is not inconsistent with being included in the management commentary. It is therefore not a source of difference between financial reporting and integrated reporting, but instead an issue specifically concerned with the financial statements.

Reporting <IR> capitals within the IFRS Framework

One way to classify information consistently between <IR> and IFRS is to anchor on financial information that is recognised in the primary financial statements. Such information would include material in the notes which disaggregates information in the primary financial statements, such as a list of operating expenses, a reconciliation showing the movements in property, plant and equipment or a schedule separating lease liabilities into time bands. We define this as *primary financial information*. Disclosures that are not primary financial information are *supplementary information*.

Given the structure of the statement of financial position in IFRS, it is clear that there is not just a generally accepted measurement of financial capital, but also partial measurement of other capitals, to the extent that they are controlled by the reporting entity. Indeed, financial capital is measured indirectly, as a claim on these (net) assets (Nobes, 2015). As represented in Figure 10.1, these are likely to include manufactured capital, along with partial recognition of intellectual capital (typically through acquisition), and partial (most likely rather limited) recognition of natural capital (for example, land or biological assets).

To the extent that intellectual capital and natural capital are not recognised, because they are not controlled or perhaps not measurable, they can be reported on in the management commentary. So, too, can human capital or social and relationship capital, neither of which meets the definitional test of an asset in IFRS, yet both of which are relevant in helping investors understand the financial impact of aspects of business performance.

Figure 10.1: Capitals in IFRS

FINANCIAL REPORTING

PRIMARY FINANCIAL INFORMATION (Financial Statements, Including Notes)

Net Assets	Equity Plus Net Debt
Manufactured Capital	Financial Capital
Intellectual Capital (Part)	
Natural Capital (Part)	

SUPPLEMENTARY INFORMATION (Management Commentary)

Intellectual Capital (Part)
Natural Capital (Part)
Human Capital
Social And Relationship Capital

Figure 10.1 links the <IR> capitals with the structure of an IFRS general-purpose financial report. The question raised by this structure is whether <IR> and IFRS are aligned, or whether there are fundamental differences not evident in the presentation in Figure 10.1. An answer to this question would provide two main insights. The first, on the main question in this chapter, concerns whether there is conflict or complementarity between <IR> and IFRS. The second, on the structure of IFRS, concerns why the IASB requires the disclosure of particular supplementary information. On the second of these questions, it is not always clear why some supplementary information is required. For example, the Basis for Conclusions that accompanies IAS 16 does not explain why the International Accounting Standards Committee (IASC) decided to include a requirement for entities measuring property, plant and equipment at fair value to also disclose the carrying amount that would have been recognised if they had applied the cost model.[vi] It could be that the supplementary disclosures are required to improve cross-entity comparability, because of the choice of measurement model in these cases, or because of concerns about relevance or reliability of fair value.[vii] The IASB has indicated that some of the disclosure requirements it is currently considering could be to help users of the financial statements assess future financial performance.

Differences between the frameworks

On the main question of conflict or complementarity, subsequent sections of this chapter will explore three possible candidates for differences between <IR> and IFRS. In brief, these differences concern whether reporting is intended to be forward-looking and predictive, as opposed to providing additional contemporaneous information (such as the variation in an estimate); whether capitals can (and should) be monetized in order to facilitate integration; and whether the reporting boundary should be drawn in different ways to serve different purposes.

Contemporaneous and predictive information

The first guiding principle in the <IR> Framework is that an integrated report should have a "strategic focus and future orientation" (IIRC, 2013, p. 16). In contrast, the IASB perceives financial statements to be "essentially backward-looking" and to contain "limited forward-looking information" (Hoogervorst, 2019a). However, the IASB sees its management commentary as the primary vehicle for providing more forward-looking information.

The IASB's characterization of the financial statements as backward-looking understates the importance of forward-oriented estimates in the recognition and measurement of assets and liabilities. IFRS Standards require that the carrying amount of every asset reflect an assessment of its recoverability. This is achieved by either measuring the asset at fair value or assessing each asset for impairment. Fair value and impairment assessments both require estimation and consideration of future cash flows. Even simple depreciation and amortization calculations require an assessment of the expected life of the asset and its expected residual value.

IFRS Standards also anticipate future cash outflows for liabilities. The cost of restoring an asset must be recognised when an entity's activities create that future obligation. For some activities this obligation arises when the entity begins the activity that is causing the damage to the land and results in a liability being recognised at the commencement of that activity. The IASB's recognition criteria make the reporting entity responsible for restoring the natural or manufactured capital of another entity, and recognizing it when it measures financial capital.

The Chairman of the IASB has suggested that the carrying value of assets recognized in relation to mineral resources, such as property, plant and equipment and assets, could be overstated if the impact of climate-related risks is not properly taken into account (Hoogervorst, 2019a). If this is the case either there is a problem with how the Standards are written or with how they are applied.

Although primary financial information incorporates forward-looking information, there are practical reasons why there could be significant estimation uncertainty associated with some assets and liabilities. Using climate change as an example, it is likely to be challenging for many entities to estimate the cash flow consequences of climate-related activities. The cash flow consequences could be beyond the normal forecast horizon of an entity, or even if an entity is able to estimate the cash flows those outflows might occur in periods so far into the future that the present value is not material to the current period financial statements. In many cases the assets will have completed their contribution to the entity before the effects of climate change have an effect on their recoverability.[viii] These considerations arise simply from time and uncertainty and so they are practical constraints for both <IR> and IFRS, as opposed to being a difference in principle between the two approaches.

In general, the objectives of the <IR> Framework seem to be broadly aligned with the IASB's Conceptual Framework and its Management Commentary Practice Statement. In particular, the <IR> Framework's explanation of the relationship between financial information and risks, opportunities and outcomes is consistent with the IASB's description of pre-financial information. The IASB states that one of the objectives of management commentary is to set out the potential impact the company's strategy will have on financial performance, which may not have yet been captured by the financial statements. The IASB uses the term "other financial information" rather than non-financial information to convey that this "other information" is a precursor to future financial performance. Management commentary:

should provide users of financial statements with *integrated* information that … explains management's view not only about what has happened, including both positive and negative circumstances, but also why it has happened and *what the implications are for the entity's future* (IASB, 2010, para. 9, emphasis added).

The discussion here suggests that, through both an <IR> and IFRS lens, future financial capital is a function of, at least some, current *supplementary information*, as well as current *primary financial information*. Using the <IR> capitals, this can be expressed as follows.

$$F_{t+n} = f(F_t, M_t, I_t, H_t, S_t, N_t,)$$

The change in financial capital is a potential independent variable. The primary source of predictive information in the financial statements is the income statement. Importantly, while the balance sheet categorises capitals independently of one another, the flow data in the income statement are implicitly integrated, the product of all of the capitals being deployed jointly (Penman, 2009; Barker and Penman, 2018). For example, the level of revenue achieved for a technology company is a function of at least financial, manufacturing, intellectual and human capitals, whether these are recognised or not.

This 'model' could be used to examine the relationship between other information and financial capital in future periods. Some entities disclose information about their customer relationships, their employees or their relationship with the environment. Presumably they choose to provide this information because they consider that those relationships have an effect on future financial performance. An entity might consider that better (worse) environmental performance attracts (discourages) customers and therefore affects future sales. This approach could also be used to assess whether supplementary information required by an IFRS Standard or regulation has predictive qualities. A positive (negative) change in future financial capital could be consistent with the actions in relation to a capital being perceived as increasing (decreasing) future cash flows—such as a change in investment in human capital increasing (decreasing) sales, a switch to more (fewer) sustainable supplies, or an increase (decrease) in social capital affecting the award of approval to build in a neighbourhood.

It might be possible to assess whether “good corporate citizens” within a sector experience a wealth transfer (i.e., between entities) when they present evidence of a shift in their non-financial capitals. For example, does a positive action in relation to a capital by one entity lead to improved future financial performance by taking market share off another entity that has not taken the equivalent steps to “improve” that capital (e.g., improved social responsibility of one entity relative to another)?

Integration, a monetary unit and changes in capitals

A feature of the <IR> Framework is that the six capitals are characterised as being contemporaneously integrated—i.e., it is the integration, trade-offs and relationships between them that are important. The question arises whether, and how, trade-offs can be evaluated if the capitals themselves are either difficult to measure or incommensurable.

The <IR> Framework describes integrated thinking as:

> 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 … that takes into account the connectivity and interdependencies between … the capitals that the organization uses or affects … including trade-offs, between them (IIRC, 2013, p. 33).

The <IR> Framework states that an integrated report is designed to show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization’s ability to create value over time. However, while the <IR> Framework offers visual ways to convey the integration, it does not provide a basis for assessing changes in capitals, either individually or collectively. The <IR> Framework does not explain how to assess trade-offs between capitals. For example, is creating employment through an activity that negatively affects the environment a positive or negative outcome? How can these effects be measured? How should externalities be interpreted, for example if aggregate capital is unchanged, yet employment benefits the entity while environmental damage imposes external costs (outside the financial boundary of the reporting entity)? The answer in the <IR> Framework appears to be that the reason for looking beyond financial capital is to focus on the risks, opportunities and outcomes that have a significant effect on the ability of an entity to create value (IIRC, 2013, p. 20). In this case, the approach is not directly concerned with the capitals themselves, but only with an entity's dependence on those capitals, which is an approach entirely in line with that of IFRS.

Mechanisms for evaluating the integration of the capitals – i.e., how a change in one capital affects other capitals – would differentiate <IR> from earlier approaches to assessing multiple aspects of performance, such as triple-bottom line and the balanced scorecard. Current practice, however, suggests a "relatively low" depth of integration (Gibassier et al., 2019). This same problem is, of course, shared with the management commentary. The difference is that the <IR> Framework emphasises that the contemporaneous relationship between the capitals is important. While <IR> appears to promise more, neither actually delivers.

The <IR> Framework states that the "capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organization" (IIRC, 2013, p. 11). The <IR> Framework includes the example of an organization improving its human capital through employee training, with the related training costs reducing its financial capital. It also refers to the possible relationships between capitals over time, stating that maximizing "financial capital … at the expense of human capital (e.g., through inappropriate human resource policies and practices) is unlikely to maximize value for the organization in the longer term" (IIRC, 2013, p. 11). This is consistent with the idea that current activities related to the non-financial capitals can affect future financial capital.

The IFRS Framework includes elements that recognize and measure changes in financial capital (income and expenses) that provide a measure of financial performance (income).[ix]

Positive (negative) income reflects an increase (decrease) in financial capital. Although the <IR> Framework refers to changes in capitals, it does not provide an equivalent to income for any of the non-financial capitals.

The elements recognised in financial statements are quantified in monetary terms. A monetary unit provides a unifying measure. IFRS Standards therefore provide a basis for presenting a stock of financial capital at a given point in time.[x] Importantly, IFRS Standards already partially capture an entity's relationships with its staff, customers and intellectual property: employees (IAS 19), customers (IFRS 15 *Revenue for Contracts with Customers*); intellectual property (IAS 38). In most cases, the recognition requirements result in these activities being captured in the income statement, rather than capitals. The information is limited, in that the flows in the income statement are typically not related to corresponding capitals, as (for example) in the case of expenditure on training (human capital) or the consumption of natural resources (natural capital).

There is no equivalent to the monetary unit for measuring the <IR> Framework's non-financial capitals. This makes comparing capitals, changes in capitals and trade-offs between them difficult, if not impossible. The <IR> Framework notes that recognizing non-financial capital "may also include monetizing certain effects on the capitals (e.g., carbon emissions and water use)" (IIRC, 2013, p. 28) but only as an example of a quantified KPI.

Overall, there appears to be no difference in substance between <IR> and IFRS with respect to whether capitals can (and should) be monetized in order to facilitate integration. There is only one, unambiguous, monetized capital in either framework, which is financial capital.

The reporting entity and reporting boundary

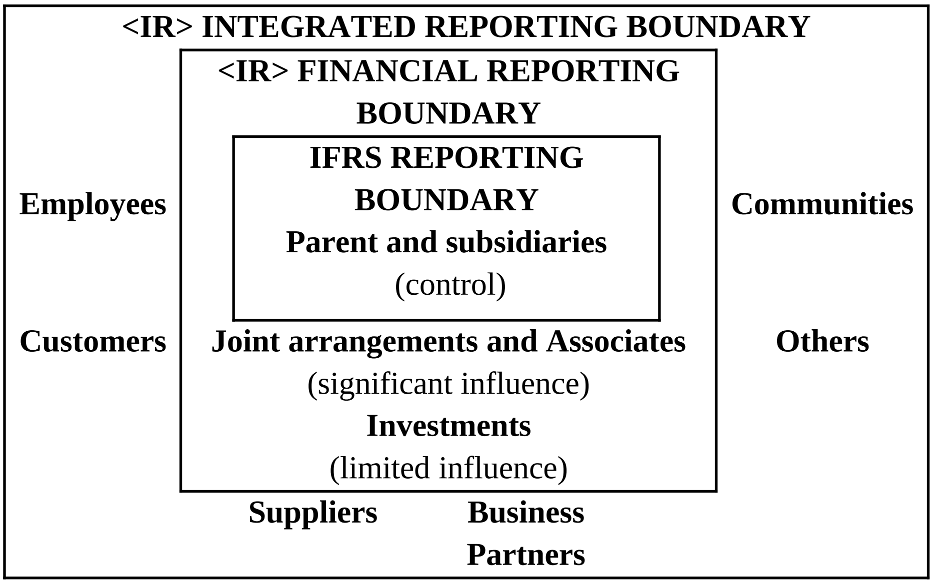
The IFRS Framework defines a reporting entity as "an entity that is required, or chooses, to prepare financial statements." A reporting entity does not need to be a legal entity. It can be a portion of an entity or can comprise more than one entity (combining two or more entities).

This definition is a relatively new addition to the IFRS Framework, having been added in the 2018 revision.

The boundaries of a financial report can be inferred from the IFRS Framework's recognition criteria, which are anchored on a control model. Once the reporting entity has been identified, or specified, the entity reports the assets it controls and the liabilities for which it is responsible, and changes to those assets and liabilities. As well as control over individual assets it includes the assets and liabilities controlled by the subsidiaries of the reporting entity.

The <IR> Framework notes that the financial reporting entity is determined according to applicable financial reporting standards, which revolve around the concepts of control or significant influence.[xi] As illustrated in Figure 10.2, the boundary for an integrated report is determined by the financial reporting entity (the boundary used for financial reporting purposes) *plus* risks, opportunities and outcomes attributable to or associated with other entities/stakeholders, beyond the financial reporting entity, that have a significant effect on the ability of the financial reporting entity to create value (IIRC, 2013, p. 19). The <IR> Framework includes an example of the labour practices of suppliers, suggesting that an integrated report is intended to capture, when it is material, activities of the supply and customer chain as well as those of the entity itself. This seems to suggest a fundamental difference between <IR> and IFRS.

Figure 10.2: The Reporting Boundary



The <IR> Framework could lead to the same factors being reported by more than one entity in the same supply chain. For example, an energy company might report its emissions along with emissions caused by its product. Corporate users of that product might also report the emissions related to that product. In a similar manner, emissions caused by a transportation company might be reported by that company as well as by users of its services. In contrast, the control criteria underlying IFRS financial statements should lead to a specific element being reported by only one entity.[xii]

It is not clear how the <IR> Framework reconciles this broader reporting of risks and opportunities with the reporting of non-financial capitals, particularly given the lack of recognition criteria in the <IR> Framework. A reporting entity does not control the public goods it uses, the community in which it operates or its customers, nor its employees or suppliers. In contrast, and as illustrated in Figure 10.2, IFRS makes a clear distinction between capitals controlled by the reporting entity and those that lie outside the financial reporting boundary but are material to it.

Based on the discussion in the previous section on trade-offs and commensurability, it does not seem realistic to measure all six capitals; nor is it consistent with the overall objective in

<IR> that focuses on the informational needs of the providers of an entity's financial capital. Hence, an apparent fundamental difference in reporting boundary between <IR> and IFRS is not really a difference at all. The relevant comparison is between <IR> and GPFR, not just the financial statements. The IASB's notion of control does not guide the inclusion of information in the management commentary, any more than it does the content of integrated reports. In both domains, information is relevant, and should be included, whether or not it concerns capitals that are controlled by the reporting entity. The overall purpose of the two approaches is not different; therefore, neither is the information that should ideally be included in each.

Summary

We have asked whether <IR> and IFRS are competing frameworks. Our answer is 'yes'. There is nothing in <IR> that differs in substance from IFRS financial reporting.

The objectives of the <IR> and IFRS Frameworks are both anchored on the financial capital of an entity and the information needs of investors. The IASB acknowledges, and the IIRC emphasises, the importance of information beyond the financial capitals.

The <IR> Framework expects an integrated report to include information about the six capitals including the interdependencies and trade-offs between them as well as how changes in their availability, quality and affordability affect the ability of the organization to create value (IIRC, 2013, p. 31). However, this expectation is effectively given no more substance than in the IASB's management commentary, which is also intended to provide supplementary information for the benefit of investors.

With respect to primary financial information, the IASB's financial statement reporting requirements are supported by 42 Standards, 20 Interpretations and a Practice Statement.[xiii] In contrast, for supplementary information, the IASB provides only the Management Commentary Practice Statement. <IR> does not have any Standards. Although there are third-party standards and guidance that address some aspects of the non-financial capitals in the <IR> Framework, none are as yet globally accepted as a basis for <IR>. There are also no standards to guide entities on the integration of these capitals.

The interest in <IR> suggests that there is at least some dissatisfaction with corporate reporting that focuses solely on financial information. The question remains as to whether <IR> can mature into a credible reporting model or whether its ideas should instead influence the IASB's GPFR requirements, and the management commentary in particular.

The IASB's Management Commentary Practice Statement already states that the information it provides should be integrated. The IASB has never explicitly acknowledged non-financial capitals, and in this regard <IR> provides a stimulus and a call to action. The IASB's project on management commentary provides an opportunity for the IASB to incorporate these aspects of the <IR> Framework principles in its Practice Statement. It also gives the IASB an opportunity to rationalise its own requirements for information supporting the financial statements, in terms of setting out principles for when supplementary information should be required and whether it should be in a management commentary or as a note to the financial statements. The Chairman of the IASB does not think the IASB is equipped to enter the field of sustainability reporting directly, because "setting sustainability reporting standards requires expertise that we simply do not have" (Hoogervorst, 2019a). However, the IASB could rely upon other bodies to develop standardised requirements for use in the management commentary. In this respect, the implication of this chapter is that <IR> does not have a role distinct from that which the IASB ought to subsume within the management commentary. The valuable role of the IIRC has been to shake up the world of corporate reporting and standard-setting, extending its scope to embrace multiple capitals. If the IASB acts to improve the Management Commentary Practice Statement to incorporate integrated thinking, it would make <IR> redundant.

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[i] The guidance is in the *IFRS Practice Statement Management Commentary A framework for presentation.* The IASB uses the term 'management commentary'. Other names for this part of an annual report include narrative report, Director's report and management's discussion and analysis (MD&A).

[ii] The IASB considers management commentary to be part of General Purpose Financial Reporting (IASB 2019b).

[iii] We use the terms Financial Report and Financial Statements in the remainder of this chapter.

[iv] Those chapters discuss Financial Statements and the Reporting Entity, The Elements of Financial Statements, Recognition and Derecognition, Measurement, Presentation and Disclosure and Concepts of Capital and Capital Maintenance.

[v] IAS 1 *Financial Statement Presentation*. All references in this chapter to individual Standards are drawn from the IASB 2019a.

[vi] IAS 16 and IAS 40 were developed by the IASC, the predecessor to the IASB. The disclosure requirements were in the versions adopted by the IASB. The IASC did not publish a basis for conclusions with IAS 16. The basis that accompanies IAS 16 was published by the IASB and relates only to amendments it made to the standard.

[vii] The disclosure requirements in IAS 16 and IAS 40 were developed when the IFRS Framework had the qualitative characteristics of relevance and reliability. The revised Framework replaced reliability with faithful representation.

[viii] There are examples of entities providing information about risks associated with climate change. For example the New Zealand company Watercare Services Limited (2018, 2019) includes in its 2018 and 2019 Annual Reports case studies that explain how it is assessing risks such as those to assets that would be more at risk if sea levels rise or are exposed to more flooding. The reports also discuss how more extreme weather such as longer droughts and greater rainfall periods could affect the supply and demand for water and could require changes to the material used in underground pipes.

[ix] The IFRS Framework has concepts of 'profit or loss' and 'other comprehensive income' that measure 'Total comprehensive income'.

[x] IFRS Standards have different measurement bases, some using current fair value with others basing the accounting on the transaction price. Although the usefulness of net financial capital that aggregates mixed measures might raise some issues about usefulness, it is nevertheless a valid aggregation.

[xi] Despite its reference to applicable financial reporting standards, the <IR> Framework mischaracterises the IASB's definition of the reporting entity. The <IR> Framework definition states that joint ventures and associates are part of the reporting entity, The IASB's reporting entity is based on a control model and therefore does not include joint ventures or associates. The IASB's reporting entity presents the net investments in joint ventures and associates, but the elements (assets, liabilities, income and expenses) of the joint ventures and associates are not the elements of the reporting entity.

[xii] This will not always be the case. Because there is some judgement involved, it is possible that some assets will be recognised by more than one entity. There are also specific examples where IFRS Standards cause a single asset to be recognised by two entities, such as when a lessor classifies a lease as an operating lease and the lessee recognises a right-of-use asset.

[xiii] The IASB has two practice statements. One addresses materiality and therefore relates to primary financial information. The second relates to management commentary.