

The IASB and Integrated Reporting

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Speaker: Hans Hoogervorst, Chairman, International Accounting Standards Board

Venue: IIRC Council Meeting, New York

Introduction

In their latest review of structure and effectiveness, from 2015 to 2016, the Trustees of the IFRS Foundation confirmed the current approach of the International Accounting Standards Board (the Board) to wider corporate reporting. Broadly, this approach is to cooperate with organisations like the Corporate Reporting Dialogue (CRD) and the International Integrated Reporting Council (IIRC).

The Board was also asked to study further what its future role should be in the wider corporate reporting landscape. The Board is examining this question now. During the Board meeting of March 2017, we devoted public discussion to this issue for the first time. We have not yet reached any conclusions, so everything I say here is tentative.

Let me start out by saying that the Board is not concerned that the relevance of financial reporting is under threat. First, because financial reporting is primarily—but certainly not exclusively—backward looking, it offers the most tangible evidence of a company’s performance. The income statement will remain the ‘hardest’ and most comparable source of information for investors.

Second, in the course of time, all value creation—also the focus of integrated reporting—will ultimately pass through the financial statements, although often with a considerable time lag. For these reasons, the financial statements will most likely remain the main anchor for investors and creditors in evaluating a company’s performance.

Conceptual Framework

Nevertheless, the Board has always been aware that financial reporting in the narrow sense has its limitations. In our *Conceptual Framework for Financial Reporting*, we acknowledge that general

purpose financial reports are not designed to show an entity's value and that users also need other sources of information to make their estimations.¹

So what information is missing in the financial statements? Users will need information about a company's intangibles—strategy, business model or technical know-how—many of which currently are not recognised in the financial statements. Users also want to know about the external environment—competition or economic developments—in which a company operates. Generally, users seek more forward-looking information than the financial statements currently provide. These elements are often included in integrated reporting.

Practice Statement

Our awareness of the limitations of financial reporting in the narrow sense is one of the reasons that the Board has already taken a cautious step into the field of wider corporate reporting. We did so in 2010 when we published our *Management Commentary Practice Statement*.

This Practice Statement encourages managers to provide context for the financial statements. It encourages management to report on the nature of the business, on its objectives and strategies, critical financial and non-financial resources, principal strategic, commercial, operational and financial risks, performance indicators and information about the entity's prospects.

All these elements of information are important components of integrated reporting. Indeed, we define the purpose of management commentary:

Management commentary should provide users of financial statements with *integrated information* that provides a context for the related financial statements (paragraph 9).

What is also interesting is that our Practice Statement states explicitly that management commentary lies within the boundaries of financial reporting. We do this by referring to paragraph 7 of the preface to IFRS Standards, which not only refers to financial statements, but also to 'other financial reporting'.² In this paragraph we make clear that information provided outside the financial statements can be useful for users in making economic decisions.

¹ *Conceptual Framework for Financial Reporting* OB7: 'General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.'

² 'Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions.'

In the meantime, thinking about integrated reporting has also evolved—become increasingly hard-nosed. According to the International Integrated Reporting Framework:

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time.

I believe this focus on value creation and the capital providers as the audience for integrated reporting are essentially compatible with the broad definition of the Board’s objectives. My conclusion is that there is considerable common ground between financial and integrated reporting.

Integrated reporting

Since the publication of our *Management Commentary Practice Statement* in 2010, the world has moved on. Interest in integrated reporting is rapidly increasing. Several important documents have been produced that have further developed thinking on integrated reporting. I would like to mention the Strategic Report Guidance by the UK Financial Reporting Council and, of course, the IIRC’s International <IR> Framework.

Both the <IR> Framework and the Strategic Report give more detailed guidance than does our Practice Statement. They put more emphasis on interconnectivity among elements of an integrated report; for example, how developments in the external environment have affected a company’s business model and strategy. Both address more clearly resources that are not included in financial statements.

The increasing awareness that environmental and societal restrictions have an impact on long-term value creation is also clear. The Financial Stability Board’s establishment of the Task Force on Climate-related Financial Disclosures is a notable example of this trend. Our Management Commentary Practice Statement is silent on the impact of environmental and social restrictions on a company’s value.

For all these reasons, the Board is currently looking at the question of whether we should update our Practice Statement to reflect these new developments. I think we have reason to do so. We are especially well-placed to make sure there is a good fit and connectivity between financial reports and non-financial information, which I believe to be essential to the success of integrated reporting.

Close

I would like to close with two comments of caution, however. First, if we decide to update our Practice Statement, I believe it will have to remain non-mandatory. This is the only way integrated reporting can succeed. More important, I would like to reiterate that we have made no decisions and

the Board needs to reflect on this very carefully. We have a history of biting off more than we can chew so we are being very careful about adding anything to our work plan.