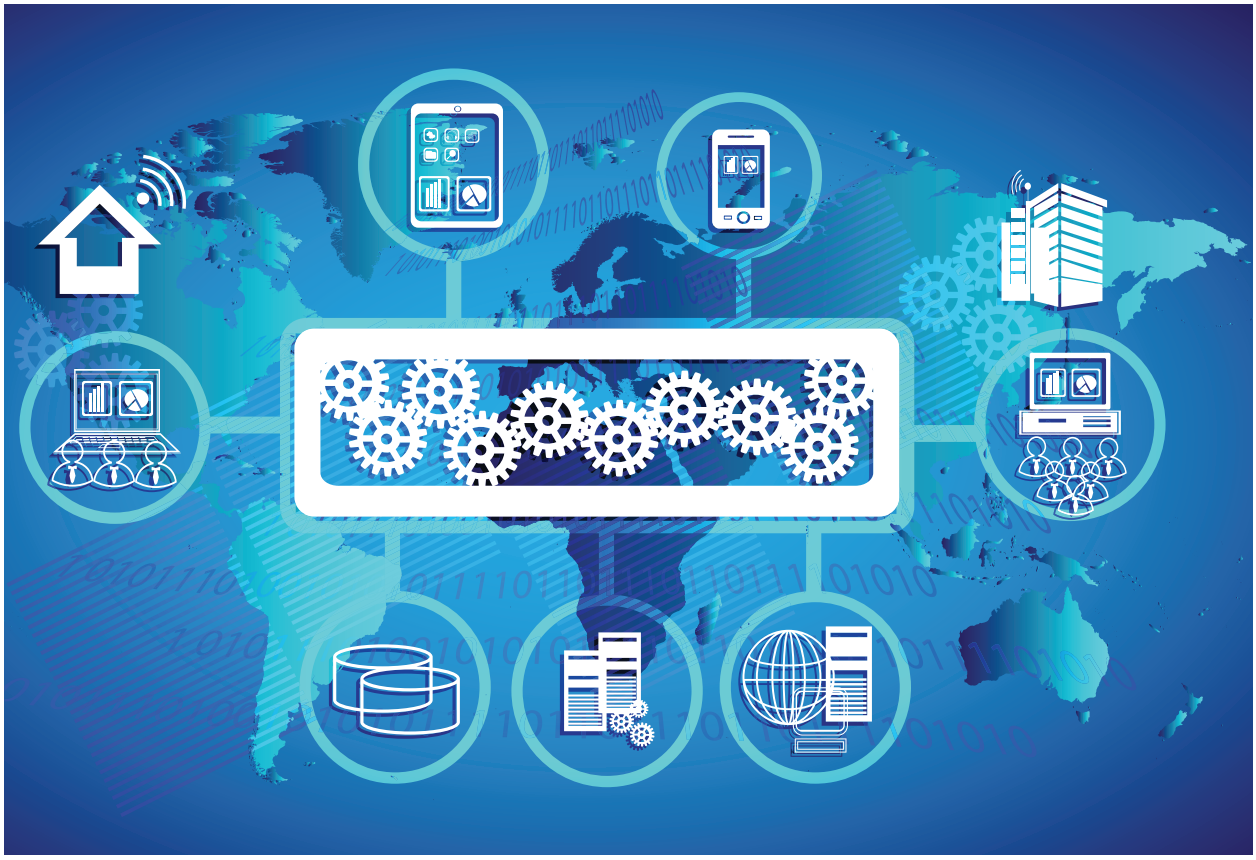
Integrated Reporting: Bridging the reporting GAAP



In the present day and age of ever evolving business environment and global factors the value of Integrated Reporting (IR), i.e. reporting which takes into consideration not only the financial information of an entity but also its non-financial information cannot be sidelined. As a concept, IR is broader and more holistic in its approach than the traditional reporting and informs the stakeholders about value creation which is integral to an entity. In the present article, the authors have aimed to give an overview of the concept of IR, highlight the journey of IR including the recent developments and provide an overview on principles and components of IR. Read on to know more….

1. Integrated Reporting - a response to evolving stakeholders' expectations

The business environment and global factors are continuously changing and so are the expectations of stakeholders over the last few decades. There has been a gradual but significant and fundamental change in the concept of 'value' from the perspective of stakeholders. Stakeholders - investors, analysts and other users of financial results - now expect companies to also disclose non-financial information and their impact on entity's strategy and business model. The current reporting framework does not provide a link between financial reporting and business strategy relevant for decision-making by stakeholders. Integrated Reporting seeks to bridge

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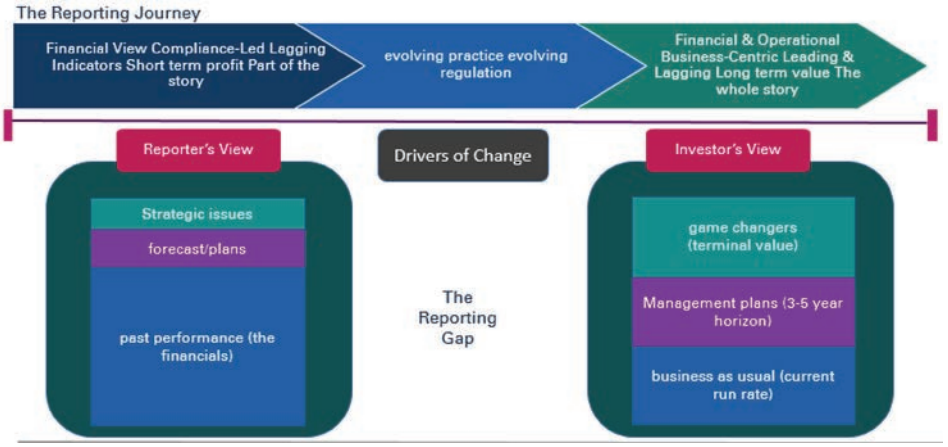
this gap by communicating how the organisation creates value.



IR in simple terms means a process through which the organisation communicates to its stakeholders how it creates and sustains value in long term. IR requires thinking about value beyond the financial terms or as reflected in the financial statements. It is broader than the traditional reporting models and tells the story of value creation which is integral to an entity. In fact, the concept of value creation is the foundation for integrated reporting.

An integrated report aims to provide insight about:

- The external environment that affects an organisation.
- The resources and the relationships used and affected by the organisation, which are referred to collectively as 'the capitals' and are categorised as financial, manufactured, intellectual, human, social and relationship, and natural. The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organisation.
- How the organisation interacts with the external environment and the capitals to create value over the short, medium and long term.

2. Background and development–globally and in India

The International Integrated Reporting Council (IIRC) was formed in the year 2010, after the concept of IR was first introduced in South Africa as a part of Code of Corporate Governance. IIRC aims to set the globally accepted integrated reporting framework so as to guide the companies on how to communicate the information expected by the stakeholders. Since then, integrated reporting has been increasingly followed by companies in various jurisdictions, either voluntarily or driven by regulatory requirements:

- In South Africa and Brazil, listed companies are required to adopt IR, as defined locally, or else explain why they have not done so.
- In Germany, disclosure requirements in respect to risk and opportunities, corporate governance and other non-financial information is required under the German GAAP.
- In France, regulation requires to include non-financial information in their annual reports.
- In the UK, the Companies Act requires the listed companies to disclose certain non-financial information mandatorily.
- In the US, certain companies have shown an interest in reporting more non-financial information voluntarily.
- India – the past practice and recent developments: Some companies such as Wipro[1], Tata Steel[2] and Yes Bank[3] have been quick to understand the changing expectations of the stakeholders and have voluntarily provided IR in their Annual reports for the year ended 31st March 2016 and 31st March 2017.

The top 500 listed entities (on the basis of market capitalisation calculated as on 31st March of every year) are required by SEBI to mandatorily submit the Business Responsibility Report ('BRR') pertaining to specified areas including environment, governance, stakeholder's relationships, etc. In response to evolving expectations of stakeholders and the global developments, SEBI on 6th February 2017, has issued a circular advising listed companies which are

[1] http://www.wipro.com/documents/investors/pdf-files/Wipro-Annual-Report-for-FY-2016-17.pdf
[2] http://www.tatasteel.com/media/3669/integrated-report-and-annual-accounts-2016-17.pdf
[3] https://www.yesbank.in/pdf/annualreport_2016-17_pdf

required to prepare BRR to adopt IR on a voluntary basis from the financial year 2017-18. This marks a big step towards implementation of IR in India.

3. Guiding Principles of Integrated Reporting – An overview

The IR framework takes a principles-based approach to strike an appropriate balance between flexibility and prescription that recognises the wide variation in individual circumstances of different organisations while enabling a sufficient degree of comparability across organisations.

The following principles underline the preparation of an integrated report:

Strategic focus and future orientation	• An insight into the organisation's strategy and how it relates to an organisation's ability to create value in the short, medium and long term
Connectivity of information	• A holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organisation's ability to create value over time
Stakeholder relationships	• An insight into the nature and quality of the organisation's relationships with its stakeholders, including how and to what extent it understands, and responds to their legitimate needs and interests.
Materiality	• Information about matters that substantively affect an organisation's ability to create value over the short, medium and long term should be disclosed.
Conciseness	• An integrated report should be concise.
Reliability and completeness	• All material matters, both positive and negative, in a balanced way and without material errors should be included.
Consistency and comparability	• The information presented should be consistent over time and shall also enable comparison with other organisations.

4. Key components of IR

An integrated report comprises the following eight components ('Content Elements') which are fundamentally linked to each other and are not mutually exclusive. The integrated report connects the Content Elements into a total picture that reflects the interactions of the organisation's activities as a whole. The order of the Content Elements as listed here is not the only way they could be sequenced and thus are not intended to serve as a standard structure for an integrated report. Rather, information in an integrated report is presented in a way that makes the connections between the Content Elements apparent and easily identifiable.

a. Organisational overview and external environment

An integrated report should provide a brief background, vision, mission and other essential information such as culture, ownership, ethics, operating structure etc. in relation to the organisation. Further, the social, environmental, political and legal factors which affect the organisation's ability to create value should also be considered. These can be specific to the organisation or industry specific or as per geographical location. These are, for instance, competitor weakness, industry trends, resource scarcity, poverty, technological changes, regulatory requirements etc.

b. Governance

An integrated report should communicate, in a clear and concise manner, about the composition of organisation governance structure (skills, gender, independence etc.) and how does it lead to the creation of value. Processes in place to address issues such as ethical integrity, equality, transparency, corruption diversity and risk management should also be highlighted in integrated report.

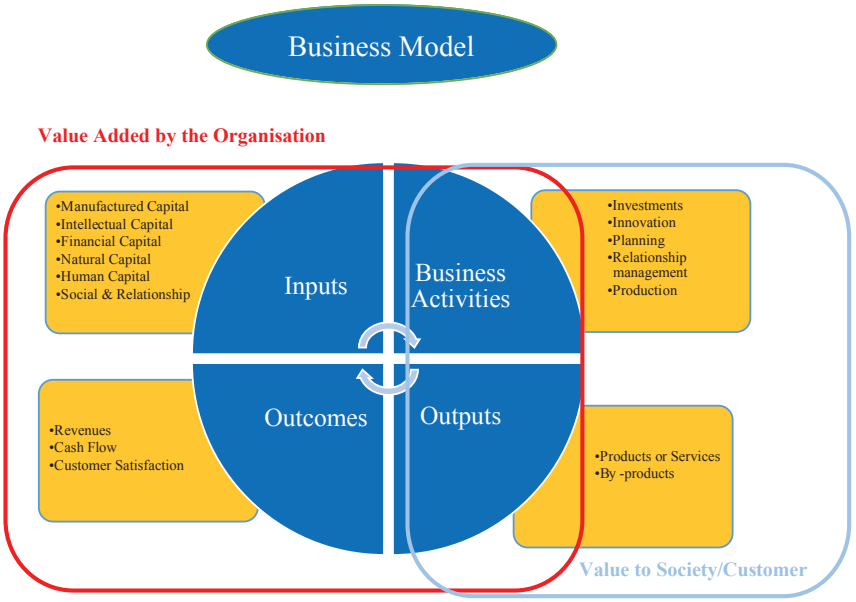
c. Business Model

At the core of the organisation is its business model, which draws on various capitals as inputs and, through its business activities, converts them to outputs (products, services, by-products and waste). The organisation's activities and its outputs lead to outcomes in terms of effects on the capitals. The capacity of the business model to adapt to changes (e.g., in the availability, quality and affordability of inputs) can affect the organisation's longer term viability.

An integrated report describes the business model, including key:

- Inputs: The capitals (resources and relationships) that the organisation draws upon for its business activities.
- Business activities: These include the planning, design and manufacture of products or the deployment of specialised skills and knowledge in the provision of services.

- Outputs: An organisation's products and services, and any by-products and waste.
- Outcomes: The internal and external consequences (positive and negative) for the capitals as a result of an organisation's business activities and outputs.



Multiple capitals can be understood as follows:

(A) Financial Capital: It refers to the funds obtained by the organisation from issue of shares, debentures (financing activity) or through normal business operations (operating activity). These are used in the production of goods or provision of services.

(B) Manufactured Capital: It includes the physical infrastructure such as buildings, PPE, technology equipment, tools etc. These contribute to the organisation's operating activity.

(C) Social and Relationship Capital: This is the capital created out of relationship between organisation and its stakeholders. It includes operating licenses, government relations, supply chain partners, customer relations.

(D) Human Capital: This comprises the skills and competence of the organisation personnel. It also includes their degree of hard work, commitment, motivation and proud in the organisation.

(E) Intellectual Capital: The brand value and reputation of the organisation in the market. Includes copyrights, patents, intellectual property rights etc.

(F) Natural Capital: It serves as the basis for the functioning of the economy as a whole. It includes all the natural resources such as water, solar energy, air, forests etc.

These Capitals can further also be divided into tangible and intangible on the basis of their physical substance. The tangible or intangible assets are either purchased or generated internally by the organisation. Thus, the organisation value depicted through IR includes internally generated intangible assets which are otherwise not recognised in the balance sheet.

d. Risks and opportunities

An integrated report should identify the key risks and opportunities which the organisation is exposed to. This includes identification of:

- Sources of risks and opportunities. (external or internal or combination of both)
- Probability of occurrence of events which will lead to risk or an opportunity
- Potential Impact on the organisation if the risk or opportunity is materialised
- Specific steps taken by the organisation to mitigate risks or identify opportunities.

e. Strategy and resource allocation

An integrated report should clearly indicate the organisation's objectives, strategies in place to meet those objectives and the resource allocation plans made to implement its strategies. It should also contain the key elements which differentiates the organisation from its competitors such as innovation, environmental and social considerations etc.

f. Performance

An integrated report should contain the performance results of the organisation measured on the basis of both qualitative and quantitative factors. The response towards the needs and expectations of the stakeholders must be provided along with

linkage of financial performance with non-financial performance (example, the ratio of carbon emissions to sales of current year vis-à-vis the previous year and the target for future year).

g. Outlook

An integrated report should also highlight the challenges and the uncertainties that the organisation expects to face in the future. This includes identifying the changes in the external environment, processes in place to respond to the changes and anticipating the effect of the change on the organisation. An integrated report should state the realistic expectations and intentions of the organisation in relation to its strategy and decision making in line with its ability to catch on the opportunities available and face the potential risks.

h. Basis of preparation and presentation

An integrated report should state how the organisation determined the matters to include in the integrated report and how such matters were quantified or evaluated including determination of materiality and reporting boundary as well as a summary of the significant frameworks and methods used to quantify or evaluate material matters.

5. Valuation of externalities

Before making an investment decision, investors consider both internal as well as external non-financial factors so as to arrive at the intrinsic value of the organisation and assess the long term prospects. However, the information currently available with investors is incomplete in terms of valuation of externalities and organisation's self-generated intangibles.

Externalities means the impact of the organisation on the society as a whole. Externalities play a major role so as to arrive at intrinsic value of the organisation. However, they are neither measured in monetary terms nor recognised in current reporting framework. Externalities can be positive or negative depending upon the nature of their impact on the society. If positive, these can be a source of competitive advantage and financial returns in the long term.

Hence, IR aims to bridge the gap between an organisation's market value and intrinsic value through valuation of externalities and also through assessment of the degree of impact of externalities on the existing intangible assets. Organisation should assess the ability of intangible assets and externalities to generate the future cash flows. These can be done by:

a) Identification of externalities
b) Estimation of value of externalities
c) Communication of both of the above to the market.

The above communication can bring the market value closer to the intrinsic value.

6. The information in relation to IR can be provided:

- as a part of annual report with a separate section on IR
- by incorporating it in management discussion and analysis, or
- by preparing a separate report (annual report prepared as per IR framework).

Reference of other reports: In case the company has already provided the relevant information in any other report prepared in accordance with existing framework or other regulatory requirements, then it may provide appropriate reference to it in its Integrated Report so as to avoid duplication of information.

Company's website: As a green initiative, the companies may also host the Integrated Report on their website and provide appropriate reference to it in their Annual Report.

7. IR will not only help the stakeholders in terms of getting the complete picture with respect to the value creation by the organisation but will also provide benefits to the organisation e.g. easy access to capital, better resource allocation, better governance, increasing brand value. However, IR does have its set of challenges which will need to be addressed to effectively leverage its benefits. Despite this, IR is the way forward since it provides a more holistic picture of an organisation's value for informed decision making by the stakeholders or despite this, IR marks an important step towards better business reporting that could ultimately bridge the gap in corporate reporting and business value. In this regard, the initiative by SEBI to implement integrated reporting provides an opportunity to listed entities in India to present their unique value creation story and achieve a more effective capital allocation. ■